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REPUBLIC OF SOUTH AFRICA

DRAFT EXPLANATORY MEMORANDUM

ON THE

DRAFT TAXATION LAWS AMENDMENT BILL, 2009



[W.P. — '09]

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1. RATES AND THRESHOLDS

Table I: Current rates for individuals and special trusts:

Taxable Income	Rate of Tax
Not exceeding R122 000	18 per cent of the taxable income
Exceeding R122 000 but not exceeding R195 000	R21 960 plus 25 per cent of the amount by which the taxable income exceeds R122 000
Exceeding R195 000 but not exceeding R270 000	R40 210 plus 30 per cent of the amount by which the taxable income exceeds R195 000
Exceeding R270 000 but not exceeding R380 000	R62 710 plus 35 per cent of the amount by which the taxable income exceeds R270 000
Exceeding R380 000 but not exceeding R490 000	R101 210 plus 38 per cent of the amount by which the taxable income exceeds R380 000
Exceeds R490 000	R143 010 plus 40 per cent of the amount by which the taxable income exceeds R490 000

Table II: Proposed rates for individuals and special trusts:

Taxable income	Rate of tax
Not exceeding R132 000	18 per cent of the taxable income
Exceeding R132 000 but not exceeding R210 000	R23 760 plus 25 per cent of amount by which taxable income exceeds R132 000
Exceeding R210 000 but not exceeding R290 000	R43 260 plus 30 per cent of amount by which taxable income exceeds R210 000
Exceeding R290 000 but not exceeding R410 000	R67 260 plus 35 per cent of amount by which taxable income exceeds R290 000
Exceeding R410 000 but not exceeding R525 000	R109 260 plus 38 per cent of amount by which taxable income exceeds R410 000
Exceeds R525 000	R152 960 plus 40 per cent of amount by which taxable income exceeds R525 000

Table III: Current rate for trusts (no change proposed):

Taxable Income	Rate of Tax
All taxable income	40 per cent of the taxable income

Table IV: Current rate for companies (no change proposed):

Taxable Income	Rate of Tax
All taxable income	28 per cent of the taxable income

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Table V: Current rate for small business corporations:

Taxable Income	Rate of Tax
Not exceeding R46 000	0 per cent of taxable income
Exceeding R46 000 but not exceeding R300 000	10 per cent of the amount by which the taxable income exceeds R46 000
Exceeding R300 000	R25 400 plus 28 per cent of the amount by which the taxable income exceeds R300 000

Table VI: Proposed rate for small business corporations:

Taxable Income	Rate of Tax
Not exceeding R54 200	0 per cent of taxable income
Exceeding R54 200 but not exceeding R300 000	10 per cent of the amount by which the taxable income exceeds R54 200
Exceeding R300 000	R24 580 plus 28 per cent of the amount by which the taxable income exceeds R300 000

Table VII: Current rates for gold mining companies (no change proposed):

Taxable Income	Rate of Tax
On gold mining taxable income	See formula in paragraph 4(b) of Appendix I
On non gold mining taxable income	28 per cent of the taxable income
On non gold mining taxable income if exempt from STC	35 per cent of the taxable income
On recovery of capital expenditure	Greater of average rate or 28 per cent of the taxable income

Table VIII: Current rate for employment companies (no change proposed)

Taxable Income	Rate of Tax
All taxable income	33 per cent of taxable income

Table IX: Current rate for long-term insurance companies (no change proposed)

Taxable Income	Rate of Tax
Taxable income of individual policyholder fund	30 per cent of taxable income
Taxable income of company policyholder fund	28 per cent of taxable income
Taxable income of corporate fund	28 per cent of taxable income

Table X: Current rate for tax holiday companies (no change proposed)

Taxable Income	Rate of Tax
All taxable income	0 per cent of taxable income

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Table XI: Current rate for non resident companies (no change proposed):

Taxable Income	Rate of Tax
All taxable income from South African source	33 per cent of taxable income

Table XII: Proposed rates for retirement lump sum withdrawal benefits

Taxable income from benefits	Rate of tax
Not exceeding R22 500	0 per cent of taxable income
Exceeding R22 500 but not exceeding R600 000	18 per cent of taxable income exceeding R22 500
Exceeding R600 000 but not exceeding R900 000	R103 950 plus 27 per cent of taxable income exceeding R600 000
Exceeding R900 000	R184 950 plus 36 per cent of taxable income exceeding R900 000

Table XIII: Proposed rates for retirement lump sum benefits

Taxable income from benefits	Rate of tax
Not exceeding R300 000	0 per cent of taxable income
Exceeding R300 000 but not exceeding R600 000	R0 plus 18 per cent of taxable income exceeding R22 500
Exceeding R600 000 but not exceeding R900 000	R54 000 plus 27 per cent of taxable income exceeding R600 000
Exceeding R900 000	R135 000 plus 36 per cent of taxable income exceeding R900 000

Table XIV: Current rebates

Description	Amount
Primary rebate	R8 280
Secondary rebate	R5 040

Table XV: Proposed rebates

Description	Amount
Primary rebate	R9 756
Secondary rebate	R5 400

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Income Tax: Monetary thresholds subject to periodic legislative change:

Table XVI: General savings thresholds

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Broad-based employee share schemes		
Maximum exemption for shares received by an employee in terms of a broad-based employee share plan	Definition of “qualifying equity share” in section 8B(3)	R50 000
Maximum deduction for shares issued by an employer in terms of a broad-based employee share plan	The proviso to section 11(IA)	R10 000
Exemption for interest and certain dividends		
Exemption for foreign dividends and interest from a source outside the Republic which are not otherwise exempt	Section 10(1)(i)(xv)(aa)	R3 500
In respect of persons 65 years or older, exemption for interest from a source within the Republic which are not otherwise exempt	Section 10(1)(i)(xv)(bb)(A)	R30 000
In respect of persons younger than 65 years, exemption for interest from a source within the Republic which are not otherwise exempt	Section 10(1)(i)(xv)(bb)(B)	R21 000
Annual donations tax exemption		
Exemption for donations made by entities	Section 56(2)(a) and the proviso thereto	R10 000
Exemption for donations made by individuals	Section 56(2)(b)	R100 000
Capital gains exclusions		
Annual exclusion for individuals and special trusts	Paragraph 5(1) of Eighth Schedule	R17 500
Exclusion on death	Paragraph 5(2) of Eighth Schedule	R120 000
Exclusion in respect of disposal of primary residence (based on amount of capital gain or loss on disposal)	Paragraph 45(1)(a) of Eighth Schedule	R1,5 million
Exclusion in respect of disposal of primary residence (based on amount of proceeds on disposal)	Paragraph 45(1)(b) of Eighth Schedule	R2 million
Maximum market value of all assets allowed within definition of small business on disposal when person over 55	Definition of “small business” in paragraph 57(1) of Eighth Schedule	R5 million
Exclusion amount on disposal of small business when person over 55	Paragraph 57(3) of Eighth Schedule	R750 000

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Table XVII: Retirement savings thresholds

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Deductible retirement fund contributions		
Pension fund monetary ceiling for contributions	Proviso to section 11(k)(i)	R1 750
Pension fund monetary ceiling for arrear contributions	Paragraph (aa) of proviso to section 11(k)(ii)	R1 800
Retirement annuity fund monetary ceiling for contributions (if also a member of a pension fund)	Section 11(n)(aa)(B)	R3 500
Retirement annuity fund monetary ceiling for contributions (if not a member of a pension fund)	Section 11(n)(aa)(C)	R1 750
Retirement annuity fund monetary ceiling for arrear contributions	Section 11(n)(bb)	R1 800
Permissible lump sum withdrawals upon retirement		
Pension fund monetary amount for permissible lump sum withdrawals	Paragraph (ii)(dd) of proviso to paragraph (c) of definition of "pension fund" in section 1	R50 000
Retirement annuity fund monetary amount for permissible lump sum withdrawals	Paragraph (b)(ii) of proviso to definition of "retirement annuity fund" in section 1	R50 000

Table XVIII: Deductible business expenses for individuals

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Car allowance		
Ceiling on vehicle cost	Section 8(1)(b)(iiiA)(bb)(A)	R400 000
Ceiling on debt relating to vehicle cost	Section 8(1)(b)(iiiA)(bb)(B)	R400 000

Table XIX: Employment-related fringe benefits

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Exempt scholarships and bursaries		
Annual ceiling for employees	Paragraph (ii)(aa) of proviso to section 10(1)(q)	R100 000
Annual ceiling for employee relatives	Paragraph (ii)(bb) of proviso to section 10(1)(q)	R10 000
Exempt termination benefits	Section 10(1)(x)	R30 000
Medical scheme contributions		
Monthly ceiling for schemes with one beneficiary	Section 18(2)(c)(i)(aa) and paragraph 12A(1)(a) of Seventh	R625

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Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
	Schedule	
Monthly ceiling for schemes with two beneficiaries	Section 18(2)(c)(i)(bb) and paragraph 12A(1)(b) of Seventh Schedule	R1 250
Additional monthly ceiling for each additional Beneficiary	Section 18(2)(c)(i)(cc) and paragraph 12A(1)(c) of Seventh Schedule	R380
Awards for bravery and long service	Paragraphs (a) and (b) of further proviso to paragraph 5(2) of Seventh Schedule	R5 000
Employee accommodation	Paragraph 9(3)(a)(ii) of Seventh Schedule	R54 200
Accommodation for expatriate employees	Paragraph 9(7B)(ii) of Seventh Schedule	R25 000
Exemption for de minimis employee loans	Paragraph 11(4)(a) of Seventh Schedule	R3 000
Additional employer deductions for Learnerships		
Monetary ceiling of additional deduction for the employer when utilising a learnership agreement with an employee	Section 12H(i)	R30 000
Monetary ceiling of additional deduction for the employer in the case of an employee completing a learnership agreement	Section 12H(2) and (3)	R30 000
Monetary ceiling of additional deduction for the employer involving a learnership agreement with an employee with a disability	Section 12H(4)	+R20 000

Table XX: Depreciation

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Small-scale intellectual property	Paragraph (aa) of proviso to section 11(gC)	R5 000
Urban Development Zone incentive	Section 13quat(10A)	R5 million

Table XXI: Miscellaneous

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Low-cost housing		
Maximum cost of residential unit where that residential unit is an apartment in a building	Paragraph (a) of definition of "low-cost residential unit" in section 1	R250 000

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Maximum cost of residential unit where that residential unit is a building	Paragraph (b) of definition of "low-cost residential unit" in section 1	R200 000
Industrial policy projects		
Maximum additional investment allowance in the case of greenfield projects with preferred status	Section 12I(3)(a)	R900 million
Maximum additional investment allowance in the case of other greenfield projects	Section 12I(3)(a)	R550 million
Maximum additional investment allowance in the case of brownfield projects with preferred status	Section 12I(3)(b)	R550 million
Maximum additional investment allowance in the case of other brownfield projects	Section 12I(3)(b)	R350 million
Maximum additional training allowance (per employee)	Section 12I(5)(a)	R36 000
Maximum additional training allowance in the case of industrial policy projects with preferred status	Section 12I(5)(b)(i)	R30 million
Maximum additional training allowance in the case of other industrial policy projects	Section 12I(5)(b)(ii)	R20 million
Minimum cost of manufacturing assets for greenfield projects	Section 12I(7)(a)(i)(aa)	R200 million
Amounts to be taken into account in determining whether an industrial project constitutes a brownfield project	Section 12I(7)(a)(i)(bb)(A) Section 12I(7)(a)(i)(bb)(B)	R30 million R200 million
Venture capital companies		
Annual deduction limit (natural persons)	Section 12J(3)	R750 000
Lifetime deduction limit (natural persons)	Section 12J(3)	R2.25 million
Investment threshold (in respect of the acquisition of qualifying shares in a junior mining company)	Section 12J(5)(e)(i)	R150 million
Investment threshold (in respect of the acquisition of qualifying shares in companies other than junior mining companies)	Section 12J(5)(e)(i)	R30 million
At least 10 per cent of the expenditure incurred by a venture capital company must be incurred in respect of qualifying shares in companies with assets with a book value not exceeding the amount indicated	Section 12J(5)(e)(ii)	R5 million
At least 80 per cent of the expenditure incurred by a venture capital company must be incurred in respect of qualifying shares in companies with assets with a book value not exceeding the amount indicated	Section 12J(5)(e)(iii)	R10 million

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Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Where a venture capital company incurs expenditure in respect of the acquisition of qualifying shares in a junior mining company, the book value of the assets held by that company must not exceed the amount indicated	Section 12J(5)(e)(iii)	R100 million
Presumptive turnover tax		
A person qualifies as a micro business for a year of assessment where the qualifying turnover of that person for that year does not exceed the amount indicated	Paragraph 2(1) of Sixth Schedule	R1 million
Maximum of total receipts from disposal of immovable property and assets of a capital nature by micro business	Paragraph 3(e) of Sixth Schedule	R1.5 million
Minimum value of individual assets and liabilities in respect of which a micro business is required to retain records	Paragraphs 14(c) and (d) of Sixth Schedule	R10 000
Public benefit organisations		
PBO trading income exemption	Section 10(1)(cN)(ii)(dd)(ii)	R150 000
Deduction of donations to transfrontier parks	Section 18A(1C)(a)(ii)	R1 million
Housing provided by a PBO: maximum monthly income of beneficiary household	Paragraph 3(a) of Part I of Ninth Schedule and paragraph 5(a) of Part II of Ninth Schedule	R7 500
Recreational clubs		
Club trading income exemption	Section 10(1)(cO)(iv)(bb)	R100 000
Prepaid expenses		
Maximum amount of deferral	Paragraph (bb) of proviso to section 23H(1)	R80 000
Small business corporations		
Maximum gross income	Section 12E(4)(a)(i)	R14 million
Housing associations		
Investment income exemption	Section 10(1)(e)	R50 000

Table XXII: Administration

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Investment income exempt from provisional tax		
In the case of natural persons below age 65	Paragraph 18(1)(c)(ii) of Fourth Schedule	R20 000
In the case of natural persons over age 65	Paragraph 18(1)(d)(i) of Fourth Schedule	R120 000

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
S.I.T.E. threshold	Items (a) and (b) of paragraph 11B(2) and items (a), (b)(ii) and (b)(iii) of paragraph 11B(3) of Fourth Schedule	R60 000
Threshold in respect of automatic appeal to High Court	Section 83(4B)(a)	R50 million

2. INDIVIDUALS AND EMPLOYMENT

2.1. TRAVEL (CAR) ALLOWANCES: REPEAL OF DEEMED KILOMETRE METHOD

[Applicable section: 8(1)(a)(i)(aa); (b)(i), (ii) and (iii)]

Background

Taxpayers can deduct the cost of traveling on business against vehicle travel allowances. The Income Tax Act (ITA) specifically views commuting expenses (i.e. traveling between home and the workplace) as non-deductible business travel. This exclusion is consistent with the notion that taxpayers cannot deduct expenses that have a mixed business/private function and which are common to most workers (such as work clothes, alarm clocks and home lunches brought to work). This exclusion is also fundamental aspect of income tax systems around the world.

To the extent that taxpayers are traveling on business (excluding commuting), taxpayers can claim a deduction against vehicle travel allowances based on the actual distance traveled (the log book method) or a deeming approach based on the total kilometers traveled (the deemed kilometer method). Under the deemed kilometer method, business travel of 14 000 is assumed if the taxpayer has driven at least 32 000 kilometers for the year at issue. If the total kilometers fall below 18 000, no business travel can be deemed.

Reasons for change

Statistical background

Tables 1, 2 and 3 provide a summary of the car allowances paid to taxpayers as well as a breakdown of expenses claimed against travel allowances and those in the production of income. Table 1 illustrates the total use of the car allowance amongst taxpayers by taxable income group during the tax years 2002/03 and 2004/05. Tables 2 and 3 provide information on amounts allowed against travel allowances (Table 2) and vehicle expenses claimed in the production of income (Table 3). These tables demonstrate that 90 per cent of those who received a travel allowance claimed deemed or actual kilometers with an average claim of 77 per cent of the average allowances received for

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2003/04. During 2004/05, 88 per cent of those who received a travel allowance claimed deemed or actual kilometers with an average claim of 79 per cent of the average allowances received.

Table 1: Travel allowances - total

Individual taxpayers - Travel allowances - 3710 taxable income	2002/03 [95.1% assessed]		2004/05 [87.0% assessed]	
	Number of taxpayers	Amount allowed per taxpayer Rand	Number of taxpayers	Amount allowed per taxpayer Rand
< 0 – 150 000	292,666	24,629	233,828	24,951
150 001 – 200 000	91,857	40,605	92,736	39,990
200 001 – 300 000	102,776	54,132	126,357	52,235
300 001 – 400 000	42,165	68,644	61,483	69,408
400 001 +	46,741	87,192	75,129	90,816
Total	576,205	40,734	589,533	46,195

Table 2: Travel allowances – deemed kilometre method

Individual taxpayers - Travel expenses fixed cost - 4014: taxable income	2002/03 [95.1% assessed]		2004/05 [87.0% assessed]	
	Number of taxpayers	Amount allowed per taxpayer Rand	Number of taxpayers	Amount allowed per taxpayer Rand
< 0 – 150 000	252,364	23,042	189,871	24,508
150 001 – 200 000	86,473	31,709	85,850	32,876
200 001 – 300 000	96,411	38,472	115,356	39,222
300 001 – 400 000	39,565	44,554	57,475	47,002
400 001 +	43,088	52,262	69,094	55,575
Total	517,901	31,436	517,646	35,819

Table 3: Travel allowances – logbook method

Individual taxpayers - Travel expenses actual cost - 4015: taxable income	2002/03 [95.1% assessed]		2004/05 [87.0% assessed]	
	Number of taxpayers	Amount allowed per taxpayer Rand	Number of taxpayers	Amount allowed per taxpayer Rand
< 0 – 150 000	13,697	20,468	8,487	22,838
150 001 – 200 000	2,114	29,159	1,643	30,070
200 001 – 300 000	2,178	33,837	1,907	34,849
300 001 – 400 000	853	38,182	802	42,472
400 001 +	1,015	44,476	993	47,879
Total	19,857	24,848	13,832	28,289

Table 4 provides a breakdown of the total vehicle expenses allowed to individuals versus other significant deductions allowed (i.e. medical and retirement). This table demonstrates that the deductions allowed per taxpayer against car allowances greatly

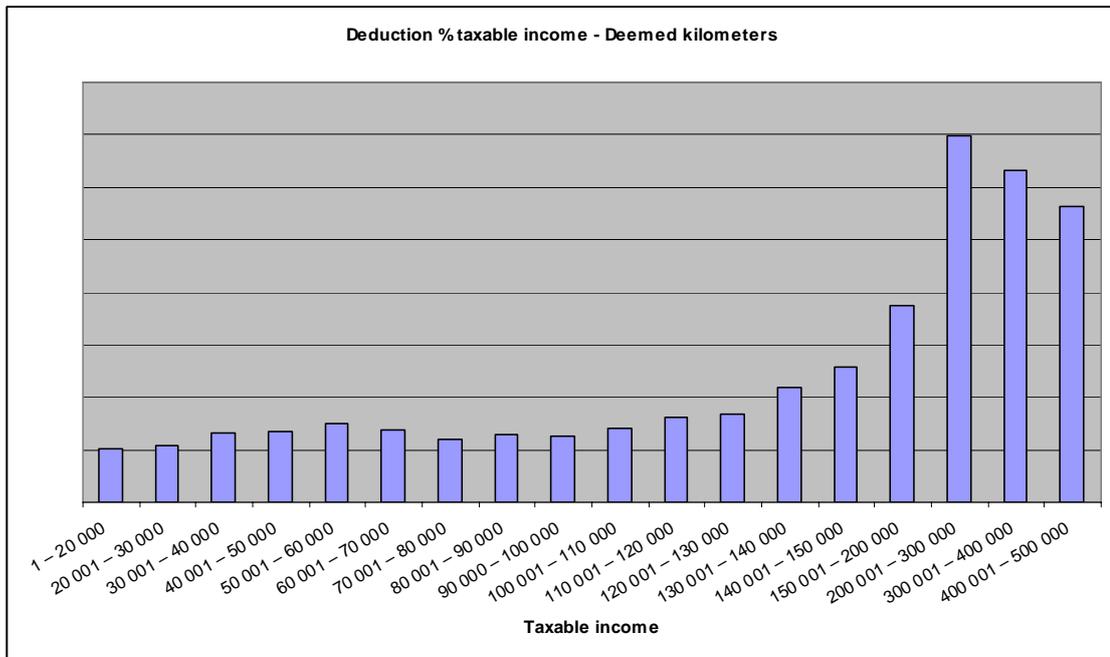
exceeded the deductions claimed for contributions towards savings funds, retirement and for medical expenses. During 2004/05, 1.4 million taxpayers were allowed R12.23 billion deductions for pension contributions whilst 517 646 taxpayers were allowed R18.54 billion against car allowances and 13 832 taxpayers were allowed R391 million for vehicle travel expenses actually incurred in the production of income.

Table 4: Aggregate deduction claims by natural persons

	2002/03 [95.1% assessed]		2004/05 [87.0% assessed]	
	Number of taxpayers	Amount allowed per taxpayer Rand	Number of taxpayers	Amount allowed per taxpayer Rand
Individual taxpayers - Deductions				
Current pension fund contributions	1,425,455	6,887	1,538,094	7,949
Current retirement annuity fund	1,097,949	4,561	1,214,332	5,299
Medical expenses (total)	1,165,392	7,170	1,291,518	8,583
Travel expenses - fixed cost	517,901	31,436	517,646	35,819
Travel expenses - actual cost	19,857	24,848	13,832	28,289
Other	177,000	20,642	132,486	29,895
Sub Total (%)	97.7%	98.7%	97.8%	99.0%
Total	4,507,215		4,813,005	

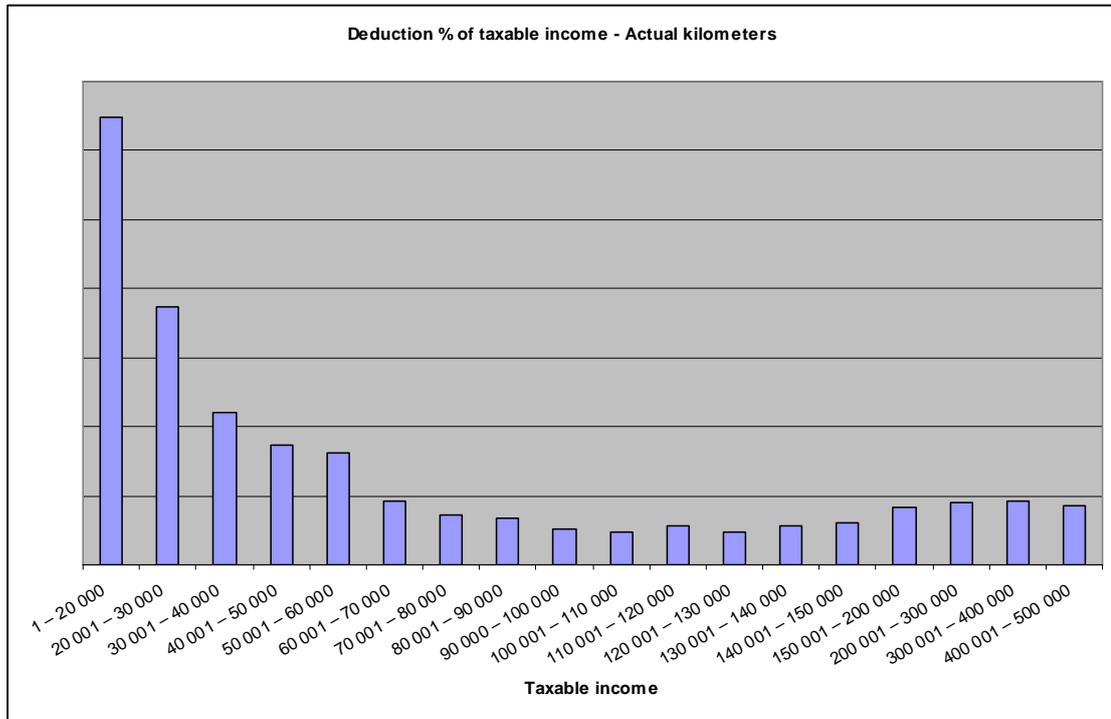
Figure 1 illustrates the distributional impact of the deductions against travel allowances. These allowances essentially add a regressive element to the income tax system by providing higher benefits to wealthier taxpayers (and by implication for more expensive motor vehicles). Figure 2 demonstrates the positive redistributive nature of actual vehicle expenses allowed and how these expenses are biased towards lower/middle income taxpayers (and by implication to more affordable motor vehicles).

Figure 1



Source: Tax Statistics (2008)

Figure 2



Source: Tax Statistics (2008)

Case against the deemed kilometre method

The case against the deemed kilometer method appears compelling. This method was created to simplify compliance and enforcement. However, this method has seemingly become a method for claiming commuting expenses (as a salary sacrifice) by anyone who drives more than a certain amount of kilometers per annum. The net effect is an incentive for longer driving, which acts against environmental objectives. It is also questionable whether many of the kilometers claimed were actually driven for business purposes.

Concerns about the deemed kilometer method have already led to previous legislative measures. These concerns were the basis for the increase in the deemed private use from 14 000 km annually to 16 000 km in 2005/6 and to 18 000 km in 2006/7.

Proposal

In view of the above, it is proposed that the deemed kilometer method be repealed. Taxpayers who are required to use their personal vehicles for business purposes will continue to be able to claim business travel expenses by way of the logbook method. The rules for company car fringe benefits may have to be revisited should it be

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necessary to align these benefits with the policy intent of the above mentioned reforms. In addition, should the repeal of the deemed kilometer method create pressure for artificial claims under the logbook method appropriate steps will be taken to prevent such potential abuse. Developments in these areas will be communicated at the appropriate time.

To ensure a smooth cash flow, the percentage of the (remaining) travel (car) allowance that will be subject to PAYE will be increased from 60 per cent to 80 per cent. The purpose of this increased percentage is to address the potential growth in taxpayers seeking to utilise the logbook method in the absence of the deemed (kilometre) method. Of concern will be taxpayers who initially claim the logbook method in terms of PAYE but who ultimately fail to substantiate the PAYE reduction claimed by year-end. The 80 per cent rule prevents significant under-withholding should these circumstances arise.

Effective date

The proposed amendment will be effective for all years of assessment commencing on or after 1 March 2010.

2.2. UNIFICATION OF EMPLOYMENT-RELATED MEDICAL SCHEME CONTRIBUTIONS

[Applicable provisions: section 18 and paragraph (12A of the Seventh Schedule)]

Background

In terms of section 18 of the Income Tax Act, taxpayers may deduct their contributions to registered medical schemes. These contributions may be for the benefit of the taxpayer, his or her spouse and any other dependant as defined in the Medical Schemes Act, 1998. Deductions for medical scheme contributions are subject to monthly ceilings that are subject to annual adjustment.

Employer contributions to employee medical schemes are generally added to the taxable income of the employee. However, an exemption exists for amounts contributed to registered medical schemes. This exemption has the same ceilings as the monthly deduction ceilings available if the taxpayer claimed the deductions under section 18.

Reasons for change

The dual medical scheme taxpayer deduction and employer fringe benefit exemptions give rise to undue complexities and evasion. For example, a taxpayer may claim the medical scheme deduction in his or her annual personal income tax return even though the same taxpayer has already obtained the benefit of the monthly exemption by way of direct employer contributions. While this practice is illegal, the current rules create a situation where enforcement may be compromised.

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Proposal

It is proposed that the fringe benefit exclusion for medical scheme contributions be removed. The net effect of this change is to require employees to claim a deduction of medical scheme contributions, whether such contributions are made by the employee or by the employer on behalf of the employee. It should be noted that the net tax effect of the change will be neutral for both employers and employees.

Effective date

The proposed amendment will be effective for all years of assessment commencing on or after 1 March 2010.

2.3. RETIREMENT OF LUMP SUM BENEFIT CALCULATIONS

[Applicable provisions: Appendix I: Paragraph 10]

Background

Two main categories exist for lump sum benefits paid by retirement funds. Lump sum benefits may be paid upon retirement (or death) or prior to retirement (e.g. due to resignation or divorce). In 2007, the exemption amount was set at R300 000 (without regard to prior years of service) for lump sums upon retirement, and the complex averaging formula for lump sum benefits upon retirement was removed in favour of a special rates table.

In 2008, the exemption for pre-retirement lump sum benefits was set at R22 500 for 2009/10 (in lieu of the long standing pre-existing threshold of R1 800). It was also announced that the complex averaging formula of section 5(10) applicable to pre-retirement lump sum benefits would be modified in favour of a simplified table.

Reasons for change

Although not technically part of the proposed legislation, it was publicly announced that pre-retirement lump sums would utilise a simplified table (in lieu of the complex averaging formula of section 5(10) that is similar to that used for retirement lump sums). The new table was said to be effective from 1 March 2009 (which coincides with the commencement of the year of assessment for natural persons). Both the pre-retirement and the retirement tables are reflected in the rate schedules contained in the explanation for Clause x1 (Tables XII and XIII) in this explanatory memorandum.

Proposal

The proposed legislation brings into effect the 2008 announcement. Also as announced, lump sum benefits will be taxed on a cumulative basis (i.e. subsequent lump sum benefits over time will be added and taxed at higher marginal rates). The cumulative nature of the system will generally be the same for both pre-retirement and retirement lump sums in terms of the rate tables. Moreover, the use of the pre-retirement exemption

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(currently at R22 500) and of the retirement exemption (currently at R300 000) will become part of the tables, thereby also becoming part of the cumulative system.

Stated differently, tax on a given pre-retirement lump sum will be determined by (1) aggregating that pre-retirement lump sum and all lump sum benefits ever received or accrued; (2) applying the pre-retirement lump sum rate table (see paragraph 10(a)(i) of Part I of Appendix I to the Taxation Laws Amendment Bill, 2009) to that aggregate amount; and (3) subtracting a “hypothetical” amount of tax already “paid” on all lump sums received prior to the pre-retirement lump sum at issue (this “hypothetical” amount being determined by applying the current rate table to all lump sum benefits previously received). These rules will be mirrored in the case of retirement lump sum benefits.

Example 1 (deduction mechanism/pre-retirement).

Facts: Nthoki is a member of two pension funds when she resigns. Nthoki initially receives a R250 000 pre-retirement lump sum from the first fund. Nthoki subsequently receives another R350 000 pre-retirement lump sum from the second fund.

Result:

The first R22 500 is taxed at rate of zero per cent, and the remaining R227 500 is taxable at rate of 18 per cent. The result is tax payable of R40 950.

In respect of the second R350 000 lump sum, this amount is effectively taxed at a rate of 18 per cent, resulting in tax payable of R63 000.

Example 2 (mixing of pre-retirement and retirement lump sums).

Facts: The facts are the same as above, except that Nthoki receives an additional R100 000 lump sum on retirement.

Result: The R100 000 is effectively taxed at a rate of 27 per cent after taking into account the prior pre-retirement lump sums, resulting in tax payable of R27 000.

2.4. MINOR BENEFICIARY FUNDS

[Applicable sections: paragraph (eC) of the section 1 “gross income” definition; section 10(i)(gE) paragraph 3(iv) of the Second Schedule]

Background

Regulatory control

Until recently, trusts administered by the Master of the High Court were the chosen vehicle used for providing funds to minor beneficiaries (i.e. those without nominees or suitable guardians). Most of these beneficiaries come from families of lesser means (e.g. mine workers and low income employees). However, lack of oversight led to mismanagement and misappropriation of funds.

In order to remedy these problems, legislative changes were made so that regulation of minor beneficiary funds partially shifted to beneficiary funds subject to supervision by the Financial Services Board (see Financial Services Laws General Amendment, 2008 (Act No. 22 of 2008)). As a regulatory matter, these beneficiary funds can only receive fund benefits as contemplated in section 37C of the Pension Funds Act, 1956 (Act No. 24 of 1956), which mainly entail payments from employer-provided retirement funds and payments from an employer-provided group life policy. The new legislative regime for beneficiary funds came into effect from 1 November 2008.

The determination of whether amounts flow into a minor beneficiary fund on the death of an employer-fund member is purely a decision of the trustees of the employer fund. As a regulatory matter, it is envisioned that minor beneficiary funds are relied upon only as a last resort option (i.e. where no otherwise existing suitable guardian, trust or other mechanism exists). All funds for the benefit of a minor beneficiary will be released upon that member reaching majority.

Tax consequences

When a member of a retirement fund dies before retirement, a lump sum tax charge arises if the heirs withdraw the funds on death, but no charge arises if the retirement fund continues to pay ongoing annuities to the heirs. This deferral for annuities promotes the continued existence of funds within retirement savings vehicles, thereby discouraging lump sum withdrawals. Like retirement fund annuities, post-death annuities grow tax-free but trigger pay-as-you-earn (PAYE) withholding as the annuity pays out to the heirs.

The 2008 tax amendments sought to place minor beneficiary funds on par with annuities on death because these funds are typically available to minor beneficiaries on a limited

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basis (proof of maintenance of life needs such as food, shelter, clothing and education). Under this annuity rollover paradigm, the transfer of retirement funds on death to a minor beneficiary fund would not be taxed, and growth within the fund would be tax-free. However, PAYE withholding will arise as the minor beneficiary fund distributes funds to minor beneficiaries. The 2008 amendments took effect from 1 March 2009.

Reasons for change

While the annuity paradigm for minor beneficiary funds is consistent with the overall philosophy for the taxation of retirement funds, the annuity paradigm gives rise to practical difficulties. Most minor fund beneficiaries are of lesser means and typically expected to receive total income below the annual taxable threshold (i.e. below the annual tax rebate), even after minor beneficiary fund payouts are fully taken into account. Preliminary estimates indicate that 80 to 90 per cent of these beneficiaries would fall below the threshold. Hence, the compliance and enforcement costs associated with PAYE do not economically justify the ultimate taxes due. The computer system required to run nil returns are especially problematic due to the low annual returns associated with minor beneficiary funds (most funds generating a yield pegged to interest rates).

Proposal

Conceptual proposal

In order to simplify compliance and administration, payouts by minor beneficiary funds will no longer be subject to PAYE. However, lump sum taxation will be imposed on the death of a retirement fund member.

Effective date

The proposed amendments will come into effect from 1 March 2009 and applies for lump sums awarded on or after that date.

2.5. REMEDIAL RECOGNITION OF PRE-1998 BENEFITS FOR PUBLIC SERVANTS

[Applicable section: Formula C of paragraph 1 of the Second Schedule]

Background

Government Employer Pension Fund ("GEPF") lump sum pension benefits became taxable in 1998, but lump sums remain outside the tax net to the extent these sums relate to pre-1998 periods (see formula C of paragraph 1 of the Second Schedule). Certain Public Service Coordinating Bargaining Council (PSCBC) resolutions provide for recognition of pensionable service of government employees if their service was previously not recognised due to discrimination (as a result of race, gender or temporary employment). These resolutions have the authority of law by virtue of Rule 10.5 of the Government Employees Pension Law of 1996 (Proclamation No. 21 of 1996). This remedial recognition often relates to pre-1998 periods.

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Reasons for change

Despite overall remedial recognition of prior pensionable service, pre-1998 Government employee pensionable service subject to previous discrimination remains unfairly treated in a tax sense. These sums should theoretically be eligible for formula C pre-1998 lump sum tax relief as if these amounts arose directly during the pre-1998 period. This failure to provide formula C relief is also inconsistent with the current pre-1998 formula C exclusion for recent recognition of pre-1998 services undertaken by non-statutory force members (Rule 10.6 of the **Government Employees Pension Law of 1996 (Proclamation No. 21 of 1996)**).

Proposal

For purposes of the formula C exclusion, the proposed amendment will add lump sums received by retiring Government employees to the extent these employees have pre-1998 service that is recognised to reverse discrimination (as provided for in Rule 10.5). This formula C tax exclusion applies even though the recognition by the board of the fund occurs after 1 March 1998.

Effective date

The proposed amendment will be effective for lump sums received or accrued on or after 1 March 2010.

2.6. TREATMENT OF UNREALIZED GAINS ON DEATH

[Applicable section: Paragraph 40 of the Eighth Schedule]

Background

For purposes of the capital gains tax, a deceased person is deemed to dispose of all assets (except for assets transferred to a spouse and for assets consisting of domestic life insurance policies or of retirement savings) to the deceased estate for proceeds equal to the market value of the assets. The assets are valued at the date of death. The net result is to trigger capital gain or loss for the deceased person on that person's final return.

In terms of acquiring assets from the deceased, the deceased estate is treated as having acquired the assets at a cost equal to the market value on date of death (i.e. is deemed to have obtained a base cost step up by virtue of the deemed disposal on death). When the deceased estate disposes of these assets to heirs and legatees, the transaction is treated as a rollover event. The estate is treated as having disposed of those asset and for proceeds equal to the cost of the deceased estate (i.e. the market value on date of death). The heir as legatee is then deemed to have acquired the assets at the same cost as that held by the deceased estate.

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Reasons for change

The current rules do not properly cater for assets directly transferred from the deceased directly to heirs or legatees (i.e. without being passed-through the deceased estate). While the deceased is taxed on all assets (except those listed), only assets passing through a deceased estate are stepped-up to market value on death. No step-up exists for direct transfers to heirs, legatees and trustees, thereby creating the potential for double taxation.

Proposal

All assets of the deceased that are subject to a deemed disposal at market value on death should receive a stepped-up cost for the transferee, not just assets transferred to a deceased estate. Therefore, comparable step-up cost rules will be added for assets directly received by heir and legatees.

Effective date

The proposed amendment should be effective for all years of assessment ending on or after 1 January 2010 (i.e. the general effective date).

2.7. LEARNERSHIP ALLOWANCE SIMPLIFICATION

[Applicable section: 12H]

Background

Basic regime

Section 12H provides an additional deduction for employers over and above the normal remuneration deduction. This additional deduction is intended as an incentive for training employees in a regulated environment in order to encourage skills development and job creation. Training contracts that qualify for the deduction are learnerships registered with a sector education and training authority (SETA) or contracts of apprenticeship registered with the Department of Labour. The additional deduction comprises of both a commencement and completion allowance.

The commencement allowance takes two forms. The allowable deduction is always the lesser of two amounts. If the learner is already employed by the employer and a learnership contract is concluded, the deduction is the lesser of either R20 000 or 70 per cent of the annual remuneration of the learner. If the learner was not previously employed by the employer at time of registration, the deduction is the lesser of either the learner's yearly remuneration or R30 000. The annual remuneration rule was inserted in order to prevent employers from utilising extremely low salaried individuals mainly in order to secure tax benefits.

A completion allowance may be claimed upon successful completion of the learnership equal to the lesser of the learner's annual remuneration or R30 000. The same basic principles apply to this allowance as the commencement allowance.

Special rules

Learners with disabilities

Enhanced deductible allowances exist for learners with disabilities. These rules assist employers to overcome financial obstacles in employing individuals with disabilities. The allowance for this category of learners operates in the same manner as the basic regime. However, the monetary value of the deductible amounts is higher. If the learner was already employed by the employer before the conclusion of the learnership contract, the deduction is the lesser of R40 000 or 150 per cent of the learners' annual remuneration. If the learner was not previously employed by the employer, the deduction is the lesser of R50 000 or 175 per cent of the learner's annual remuneration. The completion allowance is the lesser of R50 000 or 175 per cent of the learner's annual remuneration.

Employer terminations and assumption of learnerships

The whole allowance is recouped if the learnership is terminated prior to its expiry. The only exceptions are when the learner is dismissed due to incompetence or if the learner becomes physically incapacitated because of ill health or injury. If a second employer takes over a learnership from another employer, the second employer cannot claim the allowance, and the commencement allowance is recouped by the first employer.

Multi-year learnerships

Apprenticeships are of a longer duration than learnerships and therefore require special rules. In the first year, the employer may claim a commencement allowance. In the completion year (if the candidate is successful), the employer may claim successive commencement allowances for subsequent years. The employer may also deduct the completion allowance multiplied by the amount of years in the learnership.

Reasons for change

While the aim of the legislation is to encourage skills development and job creation, the complexity of the legislation is acting as a barrier to employer usage. The legislation is difficult to understand and contains too many variables. Employers (especially smaller employers) are hesitant to claim the learnership allowance because the compliance cost of administering the program seems to overshadow the benefits. The legislation accordingly needs to be simplified so that the allowance is accessible to all employers.

Proposal

In view of the above, the variables associated with the basic legislation will be drastically reduced. The revised legislation will contain two basic thresholds – a commencement allowance of R30 000 and a completion allowance of R30 000. The calculations with reference to the learner's annual remuneration will be eliminated. Recent evidence indicates that the Department of Labour prescribe minimum salaries for learners and these minimums will prevent employers from utilising extremely low-paid employees mainly to secure tax benefits.

A comparable simplification of variables will also be employed for learners with disabilities. Learners with disabilities will benefit from the basic regime outlined above with a R20 000 uplift. As a result, learners with disabilities will be eligible for a commencement allowance of R50 000 and a completion allowance of R50 000.

Employee terminations and assumption of learnerships

As stated above, if a learner terminates learnership mid-stream, a recoupment arises under current law unless the termination is caused by death or ill-health. However, this rule fails to account for practical realities in the market place. Many learners change employment for better pay or better opportunities, thereby triggering a recoupment even though the change was outside the employer's control. Some of these employment changes even entail the assumption of learnerships by the new employer in terms of section 17(5) of the Skills Development Act, 1998 (Act No. 97 of 1998).

In order to ensure that employers are not punished for events outside their control, the recoupment rule will be dropped. Instead, learnerships of less than 12 full months will be eligible only for a pro rata amount of the commencement allowance (regardless of the reason that the learnership falls short of the 12-month period). In addition, if a learnership falls over two years of assessment, the commencement allowance is allocated pro rata between both years based on the calendar months applicable to each year. The commencement allowance will be determined by multiplying the commencement amount by the total calendar months of learnership over 12.

As a result of the pro rata rule, the first employer will be eligible for a pro rata proportion of the commencement allowance upon a learner's shift to a new employer (but none of the completion allowance since the initial employer no longer has control over the learner's successful completion). The new employer seeking to assume the responsibility of a learnership pursuant to section 17(5) of the Skills Development Act will also be eligible for the remaining pro rata portion of the learnership (and all of the completion allowance).

Example:

Facts: Employer X concludes a learnership contract with a learner. At the end of month six of the contract, the learner leaves employment with Employer X and takes up employment with Employer Y. The learner subsequently completes the learnership with Employer Y (in accordance with section 17(5) of the Skills Development Act). Assume the learner does not have any disabilities and that the learnership spans a single year of assessment for both Employer X and Employer Y.

Result: The commencement amount is divided pro rata between Employer X and Employer Y (each based on a 6/12 ratio). Therefore, Employer X is entitled to a commencement allowance of R15 000 (half of R30 000), and Employer Y is entitled to a commencement allowance of R15 000 (the other half of R30 000). Employer Y is also entitled to claim the completion allowance of R30 000 (i.e. the full amount).

Simplification of multi-year learnerships

The deduction for multi-year learnerships will be simplified in order to provide for enhanced upfront benefits. The commencement allowance will now be allowed in respect of each successive year of the learnership (rather than the current situation where a single commencement amount is allowed in the first year with all subsequent commencement amounts deferred until the end). The completion allowance remains as before. In the final year of the contract, the completion amount is multiplied by the number of years of the learnership. (i.e. 12 months period)

The new rules will also have the added benefit of assisting initial employers of multi-year learnerships if learners change employment. Under the revised rule, the initial employer

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will obtain a commencement allowance attributable to the learner's initial multi-year period of employment with the subsequent employer obtaining the remaining share of the commencement allowance. As under existing law, the subsequent employer will obtain the sole benefit of the completion allowance.

Example.

Facts: Employer X (a calendar year taxpayer) concludes a three-year learnership with a learner at the beginning of January 2010. The learner shifts employment to Employer Y (a calendar year taxpayer) at the end of June 2011. The learner subsequently completes the learnership with Employer Y. Assume the learner does not have any disabilities.

Result: In 2010, Employer X may claim the full R30 000 commencement allowance. In 2011, Employer X may claim R15 000 of the commencement allowance and Employer Y claiming the R15 000 remainder. At the close of 2012, Employer Y may claim the final R30 000 commencement allowance as well as a R90 000 completion allowance (the basic R30 000 amount multiplied by three).

New legislation

The Skills Development Amendment Act, 2008 (Act No. 37 of 2008) amends certain items applicable to learnerships. In particular:

- The remaining sections of the Manpower Training Act, 1981 (Act No. 56 of 1981) will be repealed (including contracts of apprenticeship under that Act); and
- Learnerships under section 1 of the Skills Development Act will specifically include apprenticeships (with artisans also given envisioned learnership coverage under that Act).

The amendments contained in the Skills Development Act will come into operation on a date determined by the Minister of Labour by notice in the Gazette. The proposed amendments to section 12H will accordingly repeal the reference to the Manpower Act once the Minister of Labour makes the required notice. No changes will be required to include apprenticeships (and artisans) because these items will automatically fall within the current section 12H learnership definitions.

Effective date

The proposed amendments will generally be effective for years of assessment ending on or after 1 January 2010.

However, the deletions (relating to the Manpower Act) contained in section 12H(6) will be effective on the date that the Skills Development Amendment Act, 2008 come into operation.

2.8. EMPLOYER-PROVIDED POST-RETIREMENT MEDICAL AID

[Applicable section 11(nA)]

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Background

Employers provide various types of retirement benefits as a mechanism of attracting and retaining employees. One form of retirement benefit is for the employer to fully or partially cover medical aid contributions of employees after retirement. This benefit can be very expensive and risky employers because medical inflation may exceed general inflation and because chronic illnesses can be protracted.

In order to eliminate this risk, some employers seek to fully settle this liability. As a practical matter, employers with this objective may either: (i) pay the retired employee a direct lump sum payment, or (ii) purchase an annuity from an insurer with a once-off lump sum payment (with the insurer fully assuming the risk without any residual obligation). In terms of accounting, payments of this nature are viewed as a defined contribution beneficiary due to the lack of any residual legal or constructive obligation. Treatment as a defined contribution benefit allows the liability to be completely removed from the employer's books.

Reasons for change

The tax treatment of employers providing for a one-off payment in full cancellation of post-retirement medical aid contributions is uncertain. This uncertainty exists for both direct one-off payments and payments to insurers. First, these payments may be viewed as a non-deductible capital expense because the release of the liability provides an enduring benefit. Second, even if of a revenue nature, the deduction for an upfront payment is often required to be spread over the period of the benefit (in this instance, the estimated remaining lives of retired employees).

No policy reason exists for a wholesale denial of deductions in these circumstances. The cost of post-retirement medical aid is an ancillary cost of doing business. The one-off payment is not comparable to an investment reserve with all funds being paid out and all attendant liabilities being fully released.

Proposal

The lump sum payment of post-retirement medical aid contributions to retired employees (or their spouses/dependants) will be deductible immediately when paid. The lump sum can be paid directly to retired employees (or their spouses/dependants) or to an insurer for the benefit of retired employees (or their spouses/dependants).

However, this immediate deduction will not apply to lump sum payments to insurers if the employer retains a obligation whether actual or contingent relation to post-retirement medical benefits toward which the lump sum is directed. This latter precondition ensures that the shift of risk to an insurer is complete, thereby distinguishing between an investment policy (a hidden from of claiming deductions for a reserve fund) versus a true insurance policy.

Effective date

The amendment will apply to all lump sum payments on or after the date of introduction.

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2.9. DEDUCTIBILITY OF EMPLOYER CONTRIBUTIONS TO RETIREMENT ANNUITY FUNDS

[Applicable section: Section 11(n) paragraph 2(4)(DA) of the Fourth Schedule]

Background

A member of a retirement annuity fund is allowed to deduct a certain level of contributions to that fund. Conversely, a taxable fringe benefit arises to the extent an employer pays a retirement annuity fund contribution for the benefit of an employee. This result exists because the contribution is viewed as the repayment of debt, and the repayment of debt by an employer for the benefit of an employee (without reimbursement) is viewed as a taxable fringe benefit.

Reasons for change

Although retirement annuity fund contributions potentially constitute an allowable deduction when those contributions are made directly by an individual member, an anomaly exists if the individual benefits from direct employer contributions. The employer contribution gives rise to a taxable fringe benefit, but no corresponding deduction is allowed. In essence, the deduction exists only if the employee makes a contribution.

Proposal

The proposed amendment provides a deduction for any retirement annuity fund contribution in the hands of an employee even if paid by the employer on the employee's behalf. In effect, the tax system will be neutral as to who makes the retirement contribution. If the employee receives salary and makes a contribution, the salary is part of gross income with an allowable deduction for employee contributions. If the employer directly pays the contribution on the employee's behalf, the contribution is again part of gross income (as a taxable fringe benefit) for the employee, and the employee will remain eligible to deduct the contribution. The proposed amendment will be fully taken into account for pay-as-you-earn withholding.

Effective date

The proposed amendment will be effective for years of assessment commencing on or after 1 March 2010 (in line with the 2009 change to medical scheme contributions).

2.10. PAYOUTS OF EMPLOYER PENSION SURPLUSES

[Applicable sections: section (paragraph (eB) of the "gross income" definition); section 8(4)(a)(d) and proviso (a) to section 20(1)]

Background

The payment of an actuarial surplus to an employer is presently viewed as gross income without exception. This gross income is triggered when the surplus payment to the

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employer is approved by the pension board pursuant to section 15E of the Pensions Fund Act, 1956 (Act No. 24 of 1956). Assessed losses and the balance of assessed losses from previous years may not be used to offset an employer's gross income from the receipt of an actuarial surplus.

Reasons for change

As a general matter, an employer's receipt of an actuarial surplus should give rise to gross income because pension funds typically stem from deductible contributions or from tax-free or tax-preferred growth. However, circumstances may arise when an employer acquires the surplus in consequence of a non-deductible payment. For instance, an employer may acquire a pension fund surplus as part of an overall business acquisition with the allocable cost for the pension surplus being a non-deductible capital expenditure. Taxation of the pension surplus payout in this latter circumstance effectively gives rise to double taxation.

Proposal

In view of the above, it is proposed that gross income resulting from the payment of an actuarial surplus to an employer be reduced to the extent the employer made a non-deductible expenditure to acquire (or otherwise in respect of) that surplus. The net result is to ensure that the payout employer surpluses are subject to only one level of tax in the hands of the employer and no more.

Another issue is the inability to use assessed losses (and the balance of assessed losses), against gross income resulting from payment of an employer surplus. While this rule was designed to prevent timing manipulations, further information concerning the ability to make these withdrawals has come to light. The law relating to pension funds (as well as its administrative application) is fairly restrictive (being limited mainly to prevent retrenchments or to resolve liquidations), thereby preventing undo manipulation. The anti-loss rule is accordingly repealed.

Effective date

The amendment should be effective retroactively from the date (eB) came into effect in 2008. This date is years of assessment ending on or after 1 January 2009.

3. BUSINESS

3.1.CERTIFIED EMISSION REDUCTIONS – TRADABLE CARBON EMISSIONS REDUCTION CREDITS

[Application section: 12K]

Background

The Kyoto Protocol, the main environmental instrument of the United Nations Framework Convention on Climate Change (UNFCCC), has been ratified by 189 countries including South Africa. While the main purpose of the Kyoto Protocol is to generate emissions reductions for the benefit of the environment, the Kyoto Protocol provides mechanisms to ensure that Annex 1 or developed nations can meet their emission reduction targets. At the same time, the Clean Development Mechanism (CDM) ensures participation of developing countries in a global carbon reduction market. The Kyoto Protocol financing and technology transfer is accomplished through CDM projects, which are available only within developing countries. More specifically, the Kyoto Protocol presents an opportunity for financing sustainable development and technology transfers to non-Annexure 1 developing countries (such as South Africa) through CDM project development in renewable energy, energy efficiency and other related fields designed to achieve emission reductions.

A key feature of CDM projects is the demonstration of additionality, which means that the project participants must demonstrate that the envisaged project would not have been viable without CDM. Elements of “additionality” include:

1. *Emissions (environmental) additionality:* This element ensures any emissions reduction is additional to what would occur without the proposed project;
2. *Financial additionality:* This element ensures that any public funding from Annexure 1 countries for the CDM project is additional and not a diversion of pre-existing official development assistance;
3. *Investment additionality:* This element ensures that the investment project would not take place without a CDM project;
4. *Legal additionality:* This element ensures that the project is additional to what is already mandated by laws or regulations; and
5. *Technical additionality:* This element ensures that superior technology is used that would not have been possible to transfer to the developing country without the CDM project.

If these elements are satisfied, the Kyoto Protocol allows for these CDM projects to yield GHG reduction credits (commonly known as carbon emission reduction credits) in the form of certified emission reductions (CERs). These CERs are technically saleable to and usable only by Annexure 1 countries for the purpose of meeting legally binding Kyoto Protocol emissions reductions obligations. CERs effectively operate as a concomitant revenue source for CDM projects, thereby seeking to make otherwise marginal projects viable.

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Reasons for change

There has been only limited uptake of CDM projects within South Africa. This lack of uptake mainly stems from high financial (and bankable) hurdle rates, given the risk associated with CDM project activities.

The South African government fully recognises that climate change is a global environmental market failure that requires a considered international and domestic policy response. The global nature of climate change arises from the fact that a ton of carbon emitted anywhere in the world (by developing or developed countries) has the same effect on temperatures globally. South Africa's greenhouse gas emissions rank in the top 20 in the world, contribute 1.8 per cent to global emissions and are responsible for 42 per cent of Africa's emissions (primarily due to South Africa's heavy reliance on coal for electricity and its sizeable use of motor vehicles versus other forms of transport).

In terms of tax, the disposal of CERs is largely untested, thereby creating further uncertainty for CDM projects. The default interpretation is to treat the disposals of CERs as ordinary revenue from trading stock. While this tax result could be applied, taxation of CERs at full ordinary rates will add a prohibitive cost for otherwise marginal CDM projects given their high financial hurdle rates. Hence, as part of South Africa's domestic policy response to climate change, tax relief is required to overcome the market failure associated with environmental protection.

Proposal

An income tax incentive is proposed for any person that obtains CDM project registration and implements that project. The incentive applies to the disposal of CERs issued in respect of that project. In essence, the disposal of these CERs will be wholly exempt from income tax.

By way of background within the South African context, treatment of an activity as a CDM project requires both South African approval and UNFCCC registration. More specifically, South African approval is obtained from the Department of Minerals and Energy (referred to in UN parlance as the "Designated National Authority"). UN registration is provided by the UNFCCC Executive Board of the Clean Development Mechanism after validation by the UNFCCC approved Designated Operational Entity ("DOE").

CERs represent emission reductions that are verified and certified by the DOE. After verification and certification, CERs ultimately only exist once issued by the UNFCCC Executive Board of the Clean Development Mechanism.

Value-added Tax ("VAT") treatment of supplying CERS

Questions have been raised as to how the disposal of CERs should be treated for VAT purposes owing to the newness of the CERs concept. Upon review, it is believed that the supply of the CERs is a supply of "services" (as opposed to the supply of "goods"). The CER itself should fall into the ambit of a "right" or "a facility" or "advantage" envisaged in the definition of services. Internationally, countries like the UK and Sweden

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treat the supply of the CERs as the supply of services. The OECD also regards CERs as equivalent to services..

Because all CERs will be exported (being useful only for Annex 1 (industrialised) countries, the supply of CERs by persons operating CDM projects will by default (in terms of the normal VAT rules) be zero rated. Because CERs would be viewed as services, the documentary requirements are fairly liberal (i.e. being less stringent than that of exported goods).

Effective date

The proposed amendment will be effective for the disposal of CERs occurring on or after the date of introduction. This provision contains a sunset clause of 2012 based on the expiry of the Kyoto Protocol

3.2. ENERGY EFFICIENCY

[Applicable section:12L]

Background

The primary energy sources in South Africa are fossil-fuel based. Energy derived from fossil fuel has a negative effect on the environment and current electricity prices do not reflect the environmental costs. Given the need to address the challenges relating to climate change and to improve energy use, it has become necessary to find ways improve energy efficiency. Energy efficiency can indeed be viewed as one of the low-hanging fruits to help address the concerns relating to climate change and energy security.

Previous legislation provided for the establishment of the National Energy Efficiency Agency (NEEA) under the Central Energy Fund to perform functions related to energy efficient initiatives. In 2008, the National Energy Act created the South African National Energy Development Institute (SANEDI). In this revised paradigm, the NEEA will continue to perform energy efficiency functions as a division of SANEDI. Both will operate under the auspices of the Department of Energy.

Energy efficiency savings, expressed in kilowatt hours (kWh), is the favourable energy use measured against a baseline, set as a threshold by a Measurement and Verification agent. These agents are internationally recognised professionals. SANEDI will make the energy efficiency saving and determinations. SANEDI will issue the energy savings certificate, certifying the energy efficiency savings based on the information obtained from the measurement and verification agents.

Reasons for change

In the context of energy efficiency savings, the conversion by the taxpayer of old technologies to new ones often involves a substantial amount of capital expenditure for the taxpayer. Once the energy savings are realised, there will be a corresponding

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increase of accounting profits and taxable income. Therefore, government fully partakes in the profits gained from the energy savings. This tax impact creates an added hurdle to the conversion of new energy efficiency processes. The same holds, but to a lesser extent, for energy efficiency savings brought about by improvements in production processes and operating procedures.

Proposal

It is proposed that taxpayers be entitled to claim a notional allowance for energy efficiency savings resulting from activities in the production of income. This notional allowance will enable the taxpayer to capture the full profit from the energy savings during each year in which incremental energy efficiency savings is realised

The allowance for each year of incremental savings is determined as follows:

$$\frac{\text{Energy Efficiency Savings (x) Applied Rate}}{2}$$

Energy efficiency savings is determined by an accredited Measurement & Verification professional using the baseline methodology and is expressed in kilowatt hours (kWh) and certified by SANEDI (see terms of certificate below). The applied rate is the lowest feed-in-tariff expressed in rands per kWh determined in terms of the Regulatory Guidelines by the National Energy Regulator. Given that the lowest feed-in tariff rate is higher than the current rate per kWh for electricity generated from fossil fuels the allowance is 50 per cent (the division by 2) of the amount derived by multiplying the energy efficiency gains with the applied rate. The Minister may change this percentage, (i.e. the amount by which the rand value of the savings is divided). It would have been possible to use the average actual electricity rate (rand per kWh) for each taxpayer but; this approach would have resulted in unnecessary administrative and differential benefits.

The energy savings certificate is the key pre-requisite for the allowance. The certificate must contain the M & V determined energy used baseline, the annual energy efficiency savings expressed in kilowatt hours (kWh) and the revised baseline. All this information must be authenticated and issued by SANEDI

All the criteria and methodology used to determine the baseline and the energy efficiency savings must be in terms of regulations issued by the Minister of Energy. The regulations will be based on the *International Performance Measurement and Verification Protocol* of the Efficiency Valuation Organisation.

Effective date

The amendment is effective for years of assessment ending on or after 1 January 2010. This provision also has a sunset clause, resulting in the expiry of the incentive on 1 January 2020.

3.3. PRE-SALE DIVIDENDS/DIVIDENDS STRIPPING

[Applicable sections: section 22B; paragraphs 19;43A of the Eighth Schedule]

Background

The new Dividends Tax imposes a 10 per cent tax on dividends paid to a person who is a beneficial owner of the dividend. The tax is imposed at the shareholder level. Certain shareholders are exempt from the Dividends Tax, including South African companies.

Proceeds from the disposal of shares held as capital assets are subject to the capital gains tax at a rate of 10 per cent for individuals and 14 per cent for companies. Proceeds from the sale of shares held as trading stock are subject to income tax at 40 per cent in the case of natural persons and at 28 per cent in the case of companies.

Reasons for change

The new Dividends Tax can give rise to arbitrage opportunities for company shareholders. In particular, an incentive exists for company shareholders selling shares to convert those sale proceeds to dividends. This conversion eliminates capital gains subject to a 14 per cent (50 per cent of 28 cent) rate with dividend treatment that is exempt from tax.

The conversion of taxable sale proceeds to exempt dividends requires some basic mechanics. In the simplest case, the target company being sold can distribute excess profits to the selling shareholders. These pre-sale dividends will reduce the selling price (thereby reducing sale proceeds for purposes of the capital gains tax calculation). Pre-sale dividends of this nature may involve distributions by the target company of excess cash or of assets unwanted by the purchaser.

Oftentimes, however, the target company does not have excess cash nor assets that are unwanted by the purchaser. In these instances, the conversion of capital gains to pre-sale dividends will require indirect support from the purchaser. This indirect support can come in a variety of forms:

The prospective buyer can make a contribution to the target company in exchange for target company shares so the contribution proceeds can be distributed as a pre-sale dividend; or

The target company can take out a loan from the purchaser or that is guaranteed, secured or otherwise initiated by the prospective purchaser so the loan proceeds can be distributed as a pre-sale dividend.

While an argument could be made that pre-sale dividends are a mere accumulation of profits that should have been distributed previously, this argument becomes suspect once the cash funding is coming from the purchaser. Purchaser-funded pre-sale dividends economically amount to sale proceeds and are utilised almost exclusively to undermine the South African tax base.

Proposal

This proposal seeks to deny the company shareholder arbitrage advantage arising from arrangements involving pre-sale dividends that are directly or indirectly funded by

purchasers. This proposal falls into three parts: (i) dividend conversions to capital gain proceeds, (ii) dividend conversions to trading stock gross income, and (iii) refinement of the anti-capital loss pre-sale dividend rule.

Dividend conversion to capital gains proceeds

This proposal seeks to prevent the conversion of taxable capital gain proceeds to exempt pre-sale dividends. This rule essentially applies when a person disposes of shares in a target company if four conditions exist:

1. the person disposing of the shares is a domestic company;
2. that person holds at least 20 per cent of the shares in a domestic target company (taking into account section 1 group company ownership);
3. that person or connected person received a dividend in respect of the target company shares two years prior to their disposal; and
4. the target company is viewed as having received pre-funding from the purchaser.

Pre-funding will be deemed to exist in two general circumstances. First, pre-funding will be deemed to exist if, two years before the disposal, the purchaser of the disposed shares contributed funds to the target company in exchange for target company shares. Second, pre-funding will be deemed to exist if the target company borrows funds two years before the disposal and the borrowing is: (i) obtained from the purchaser, (ii) guaranteed or secured by the purchaser, or (iii) otherwise obtained by reason of or in consequence of the share disposal. For purposes of both sets of pre-funding rules, the term “purchaser” includes any connected person in relation to that purchaser immediately before the share disposal, and the term “target company” includes any connected person that is a company in relation to that target company immediately before the share disposal.

Example:

Facts: Parent Company owns all the shares in Subsidiary, which have been held for many years. Parent Company's shares in Subsidiary have a base cost of R3 million and a market value of R5 million. Subsidiary takes out a loan of R2 million (guaranteed by Purchaser) and distributes R2 million to Parent Company as a dividend. Immediately after the dividend, Parent Company sells the Subsidiary shares to Purchaser for R3 million.

Result: In the absence of the pre-sale dividend rule for capital gains, the dividend of R2 million would be exempt in the hands of Parent company. The proceeds from the sale of subsidiary would also have no capital gains since the sale proceeds do not exceed the subsidiary's base cost (once the pre-sale dividend is taken into account). With the pre-sale dividend rule, the R2 million dividend paid to the Parent Company will be additional proceeds in the hands of Parent Company, thereby triggering capital gains tax on the R2 million of deemed gain.

Trading stock dividends

The rule for trading stock will mirror the rule for capital gains. This rule for trading stock prevents the conversion of gross income into exempt pre-sale dividends. If the pre-sale dividend rule for trading stock applies, the dividend received by the company disposing of the target company shares will be included in the disposing company's gross income. This rule will apply in addition to the case law on dividend stripping (see CIR v Nemojim (Pty) Ltd, 45 SATC 241).

Example:

Facts: Parent Company owns all the shares in Subsidiary, which have been held for many years. Parent Company's shares in Subsidiary have a cost price of R3 million and a market value of R5 million. Subsidiary takes out a loan of R2 million (guaranteed by Purchaser) and distributes R2 million to Parent Company as a dividend. Immediately after the dividend, Parent Company sells the Subsidiary shares to Purchaser for R3 million.

Result: In the absence of the trading stock rule for pre-sale dividends, the dividend paid to Parent Company will be exempt. Parent Company would also have gross income of only R3 million (which is fully offset by the section 22 starting cost price). With the new pre-sale dividend rule, the R2 million dividend paid to Parent Company will be included in Parent Company's gross income (thereby generating a net of R2 million of ordinary revenue).

Anti-capital loss rule

The anti-capital loss rule of paragraph 19 of the Eighth Schedule will remain as a backstop. This rule ensures that taxpayers selling shares may not benefit from artificial losses generated by pre-sale dividends. However, the rule going forward should apply only to selling domestic companies because the CGT arbitrage in the context of the new Dividends tax will only exist in these circumstances.

Effective date

The effective date for all of the above provisions is the date on which section 56 of the Revenue Laws Amendment Bill 80 of 2008 becomes effective (i.e. the date the new Dividends Tax becomes effective).

3.4. DIVIDENDS TAX: SPECIALISED REGULATED INTERMEDIARIES

[Applicable sections: 64D (i) ("regulated intermediary" definition) 64H (iA), (5) and (6), 64i 93a)]

Background

The new Dividends Tax contains various withholding rules. As a general matter, the company declaring the dividend is initially liable for withholding in respect of the 10 per cent charge. However, this withholding liability can shift to an intermediary if that intermediary temporarily holds the dividend before the dividend is eventually relayed to the ultimate beneficial owner.

Intermediaries come in two forms – regulated or unregulated. Regulated intermediaries bear the full weight of withholding; whereas, unregulated intermediaries play a more limited role. Both a collective investment scheme in securities ("CIS") and a life insurer are viewed as regulated intermediaries.

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Reasons for change

Both the CIS and the life insurer are a unique form of regulated intermediary. Unlike other regulated intermediaries, the CIS and the life insurer do not operate as a pure nominee that passes on dividends immediately when received.

A CIS typically holds dividends received, and other ordinary revenue amounts, for a period of three to twelve months (depending on the terms of the CIS trust deed). The CIS then passes the dividends received and other ordinary revenue amounts, (less allocable expenses such as management fees) to the CIS unit holders.

Under the four funds approach of section 29A, a life insurer receives dividends for the ultimate benefit of its shareholders (like any other company) or in its capacity as a regulated intermediary. As a regulated intermediary, a life insurance company can receive dividends for the ultimate benefit of exempt policy holders, company policy holders and individual policy holders. In these instances, the dividend is never passed on to the policyholders as such – only the value redounds to their benefit.

The unique nature of these regulated intermediaries accordingly requires special rules so that the dividends involved are appropriately taxed without giving rise to an undue disadvantage or advantage vis-à-vis other regulated intermediaries.

Proposal

Revised intermediary treatment of the CIS

Due to other changes associated with this amendment Bill, the CIS will no longer be viewed as a company for purposes of the Dividends Tax (see “Conduit Principles for Distributions by a Collective Investment Scheme”). The receipt of dividends by a CIS will now be viewed as a receipt by a regulated intermediary under specific conditions. As such, the CIS will generally be required to withhold Dividends Tax in respect of dividends declared from companies that are on-distributed by the CIS to the CIS unit holders (section 64H(1)). This on-distribution typically occurs some three, six or twelve months after the dividend is initially received by the CIS).

A special rule will also be added if the CIS fails to on-distribute dividends received within 12-month period after acquisition. Under these circumstances, the CIS will be deemed to on-distribute the amount to natural persons who are residents (i.e. the amounts will be subject to withholding under the Dividends Tax without potential relief). This distribution will be deemed to occur at the close of the 12-month period after the dividend is initially acquired by the CIS.

Revised intermediary treatment of life insurance companies

No withholding is required when dividends are paid to a life insurer by virtue of the fact that the life insurer is both a company and a regulated intermediary. Two sets of rules are required to account for the fact that the life insurer not only receives dividends in its own capacity but also in its capacity for the benefit of individual, company and exempt policyholder funds.

The life insurer will be required to withhold the Dividends Tax in respect of amount allocable to the individual policyholder fund. This charge will be triggered (without potential exemption) when the allocable dividend amounts accrue to the life insurer. Payment will be due by the last day of the month following the month during which the

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dividend accrued. No Dividends Tax is due in respect of the company and exempt policyholder funds.

It is to be noted that some life insurers rely on reasonable estimates during the course of the year for determining ownership amongst the four funds. These life insurers then perform actuarial valuations at the close of the financial year to re-align this ownership determination which serves as the basis for the reasonable estimate in the following year. It is understood that these reasonable estimates will be respected for purposes of the Dividends Tax in respect of the individual policyholder fund (without the need for rectifying the amount due if the close of year actuarial valuation differs from the mid-year reasonable estimate).

In its role as a profit-making company acting on behalf of its shareholders (i.e. in respect of its corporate fund), the life insurer will receive dividends free of Dividends Tax like any other company. However, any STC credits associated with dividends received by the life insurer will be limited to those dividends associated with the corporate fund (no STC credits will be available in respect of dividends associated with life insurer policy holder funds).

Effective date

The proposed rules will come into effect along with the new Dividends Tax (see Clause 56(2) of the 2008 Revenue Laws Amendment Act). This date is at least three months after the Minister gives notice in the government Gazette.

3.5. DIVIDENDS TAX: WITHHOLDING REFINEMENTS

[Applicable sections: Section 64E (3); 64G; 64H; 64K (2)(c); 64L; 64M)

Background

The main object of the new Dividends Tax is to convert the current system of imposing tax on companies (pursuant to the Secondary Tax on Companies) to a system of imposing tax on company shareholders. While the new system is better aligned with international practice, the new system is undoubtedly more complicated. One key complication relates to the withholding mechanism. This mechanism must now cover a wide range of shareholders under differing tax circumstances versus the current charge on a single paying company.

In essence, the new system initially requires the company declaring the dividend to withhold the Dividends Tax on payment. However, responsibility for this withholding shifts to intermediaries if the dividend arises in respect of uncertificated shares (i.e. paperless shares of a listed company). The withholding tax for both the paying company and the regulated intermediary can also be relieved if the beneficial owner provides a timely written declaration that the beneficial owner is entitled to exemption or tax treaty relief.

Reasons for change

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The new Dividends Tax was brought into legislation long in advance of the effective date so as to provide the impacted parties with sufficient time to adjust their compliance systems. Another advantage of this early release is to allow for legislative adjustments based on comments received as new compliance systems are established.

As anticipated, a number of issues have arisen in respect of the withholding system requiring adjustment. These issues involve the treatment of linked investment service providers, the role of unregulated intermediaries and special rules for dealing with dividends *in specie* (e.g. a distribution of subsidiary shares).

Proposal

A. Linked investment service providers

A linked investment service provider (“LISP”) is a financial institution that packages, distributes and administers a broad array of unit trust arrangements (including voluntary and retirement products). A LISP is essentially a single portal of investment choices supported by a financial advisor. A LISP can operate purely as an administrative vehicle or as a discretionary vehicle with an independent ability to exercise investment decisions.

Companies, regulated intermediaries and collective investment schemes making payment to LISP vehicles effectively deal with the LISP as a separate entity with the LISP acting as an interface at the retail-level. Therefore, it is proposed that LISP vehicles (i.e. nominees appointed by administrative and discretionary financial service providers) be treated as a regulated intermediary so that the LISP becomes the primary withholding agent for the Dividends Tax.

Twin regimes: Certificated and uncertificated shares

Upon review, it has become apparent that the withholding rules under the new Dividends Tax are not entirely clear. Issues exist as to the role of intermediaries and the most efficient means of claiming exemption.

The proposed legislation revises the withholding regime in favour of two sets of rules – one for dividends in respect of certificated (i.e. paper) shares and the other for dividends in respect of uncertificated (i.e. electronic) shares. In the case of certificated shares, the overall onus of withholding falls upon the company declaring and paying the dividend. In the case of uncertificated shares, the overall onus of withholding falls upon regulated intermediaries.

i. Dividends in respect of certificated shares

As a general rule, the company declaring and paying dividends in respect of certificated shares will be subject to withholding. Beneficial owners seeking to claim exemption or treaty relief will have to do so directly. Intermediaries will generally have no role in the case of certificated shares, except possibly Collective Investment Schemes in shares. Collective Investment Schemes in shares sometimes receive dividends in respect of certificated shares that are rated (typically preferred shares). Collective Investment Schemes receiving this form of dividend may claim exemption, but will be required to

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withholding when making a distribution to unit holders of amounts derived from these dividends (see notes on DIVIDENDS TAX: SPECIALISED ENTITIES).

ii. Dividends in respect of uncertificated shares

The general dividend withholding agent for uncertificated shares is the regulated intermediary. Payment of uncertificated share dividends by regulated intermediaries will fall under four scenarios:

Direct payments to domestic beneficial owners: Payments made directly to a domestic beneficial owner will be taxable unless the beneficial owner claims exemption by written declaration. The declaration process is essentially the same as for exemption claims made in the case of certificated shares.

Payments to regulated intermediaries: Payments made directly to a regulated intermediary are exempt. The payee regulated intermediary essentially steps into the shoes of the initial payor.

Payments to unregulated intermediaries: Payments made directly an unregulated intermediary will be taxable unless the regulated intermediary claims exemption by written declaration. The unregulated intermediary can claim exemption only on behalf of domestic beneficial owners and by indicating the total percentage of dividends allocable to domestic exempt beneficial owners. The declaration must be made per dividend by a date determined by the regulated intermediary payor. Regulated intermediaries making this claim for exemption become jointly and severally liable for any errors in this regard.

Payments for the benefit of foreign beneficial owners: Payments made for the benefit of a foreign beneficial owner will be fully taxable unless the beneficial owner claims treaty relief or exemption by written declaration (note: foreign beneficial owners are exempt in respect of foreign dividends distributed by a foreign company listed on the JSE). The declaration process is essentially the same as for domestic beneficial owners. Foreign beneficial owners may not rely on unregulated intermediaries to claim exemption on their behalf.

iii. Information reporting in respect of foreign beneficial owners

All payors subject to reduced withholding by virtue of declarations by foreign beneficial owners must submit a copy of these beneficial declarations with the dividend withholding payment. This rule applies in respect of both certificated and uncertificated shares.

iv. Refunds in respect of certificated and uncertificated shares

Like the basic withholding rules, the refund rules will be divided between certificated and uncertificated shares. The refund rules for certificated shares will remain as initially created (claims within one year are made against the company payor and subsequent claims for years two and three are made against SARS).

In the case of uncertificated shares, SARS will no longer be part of the equation. Claimants will have three years to request refunds from the regulated intermediary. No refund claims will be permitted against SARS in the case of wrongful withholding in

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respect of uncertificated shares. Regulated intermediaries transmit dividends (i.e. the source of refunds) so frequently that sole reliance on regulated intermediaries for refunds should be the most efficient remedy. *Note:* If a regulated intermediary withhold funds paid to a unregulated intermediary due to a late declaration or other reason, the unregulated intermediary must submit the claim for refund (not the beneficiary).

Dividends in specie in respect of uncertificated shares

As presently formulated, the withholding rules under the new Dividends Tax are the same for cash payments as dividends in specie. In specie dividends raise complications because the value of the shares distributed change throughout the process, especially in the case of uncertificated shares. This changing value means that the parties subject to withholding will have a difficult time setting values for purposes of the 10 per cent Dividends Tax withholding calculation.

In order to simplify the calculation, it is proposed that the parties involved be allowed to rely on a deemed value. This deemed value will be based on the practical mechanics required to pay the tax. More specifically, the parties must raise sufficient cash to pay the 10 per cent tax on the dividends in specie. This cash is best raised by selling a portion of the item in specie – a sale most easily performed by the company making the distribution. It is this sale that will serve as the basis for all Dividends Tax.

Example.

Facts. Listed Company has 2 million uncertificated shares outstanding. Listed company plans to distribute 6 million shares of a partially owned subsidiary. The distribution of the subsidiary shares will be a dividend (i.e. the transaction will not qualify as a tax-free unbundling). Listed Company declares the dividend on 10 May 2014 with the last date to register on 1 July 2014. The distribution will occur on 9 July 2014. In order to raise funds to pay the withholding charge required by the Dividends Tax, Listed Company sells 600 000 subsidiary shares on the open market. The average price per subsidiary share received by Listed Company is R25. The average price per subsidiary share on the date of distribution is R27. Listed Company distributes the 5,4 of subsidiary shares as well as the full cash proceeds of R15 million) to regulated intermediaries so they can transmit the full dividend.

Result. The R25 per share amount will be the value set for all Dividends Tax purposes. This set value will apply to all applicable parties involved (i.e. Listed Company, the intermediaries and the shareholders).

D. Capital distributions versus dividends: Notification

Dividend distributions have a very different impact for shareholders than capital distributions. Dividends fall under Part VIII, typically triggering a 10 per cent withholding charge with exemptions. Even though the tax falls on the shareholder, various payors ultimately bear most of the responsibility of collecting the tax. Capital distributions, on the other hand, fall under the Eighth Schedule. These distributions trigger a deemed disposal event, potentially subject to an effective 10 per cent charge for individual shareholders and an effective 15 per cent charge for company shareholders. Capital distributions do not require withholding, and a responsibility for the year-end payment falls entirely on the shareholders.

While the current law requires a written determination, this determination needs to be relayed to the shareholders. The shareholders need this information to make their capital gain or loss computations. Therefore, the contributed tax capital definition needs to be modified. In addition to the determination in writing required under current law, the

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definition requires the company to notify all parties to whom the transfer is paid that the distribution will stem from contributed tax capital (and the extent of the distribution allocable to contributed tax capital versus a dividend).

Effective date

The proposed amendment will be effective along with the new Dividends Tax. Hence, this amendment will come into effect on a date set by the Minister by notice in the Gazette, which date must be at least three months from the date of the notice (see clause 56(2) of the 2008 Revenue Laws Amendment Act).

3.6. DIVIDENDS TAX: DISTRIBUTIONS OF SHARES AND SHARE RIGHTS

[Applicable provisions: sections 1 (“dividend” definition); 64;R VIII and paragraph 74 (“capital distribution” definition) of the Eighth Schedule]

Background

The STC system imposes tax at a company level and treats the distribution of capitalisation shares as a non-tax event. More specifically, the distributed capitalisation shares do not constitute a dividend. In terms of accounting, a share distribution is treated as a conversion of company profits to the company’s reserves (or to the share capital account). Yet, despite this accounting treatment, the STC system does not recognise the conversion and the profits converted effectively remain as profit for purposes of the dividend definition.

The new Dividends Tax shifts the tax charge to the shareholder level. The new tax again treats the distribution of capitalisation shares as a non-event. The distributed shares do not constitute a dividend, and no increase arises in respect of the distributing company’s contributed tax capital (“CTC”).

Reasons for change

Both the STC and the Dividends Tax systems do not take into account changes in the relative proportionate equity share interests in the distributing company. As a result, these systems do not address value shifting arrangements that increase the proportionate equity share interests held by some shareholders at the expense of others. This omission is problematic because the Income Tax is designed to tax the realisation of increased value.

Proposal

Basic paradigm

Share distributions will remain exempt from the Dividends Tax as long as the distribution does not result in any change in the proportionate equity share interests of the

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shareholders. However, if a change arises, the share distribution gives rise to a taxable dividend. This taxable change in proportionate interests can occur within a class of shares or within the equity share interests of the company as a whole.

Share distributions giving rise to taxable dividends should conceptually be regarded as a cash dividend followed by a contribution of that cash to the company in exchange for newly issued shares. The share dividend amount subject to the Dividends Tax should equal the market value of the shares distributed as at the date of distribution. This taxable amount should also give rise to a corresponding increase in CTC in respect of the class relating to the shares distributed.

Example:

Facts: Company X has two classes of shares: 500 000 of ordinary shares and 250 000 of preference shares. The preference shareholders have a right to cumulative dividends. The cumulative preference is in arrears.

Company X announces a distribution of 1 ordinary share for each preference share (with no option to elect cash). The value of each ordinary share distributed is R25. Preference Shareholder A holds 1 000 preference shares and receives a distribution of 1000 ordinary shares.

Result: The ordinary shares distributed to the preference shareholders give rise to a taxable dividend because the proportionate interest of all the preference shareholders has increased in relation to the ordinary shares. The ordinary share distribution to Preference Shareholder A will result in R25 000 of taxable dividends (with a CTC increase of R25 000 in respect of the ordinary shares).

Share distribution elections

In some cases, a company may provide its shareholders with an option to receive a cash distribution or a share distribution. This option may be formatted in several ways. For instance, the company could announce: (i) a share dividend with an option to choose cash by a certain date, (ii) a cash dividend with an option to choose shares, or (iii) a simple upfront election to choose cash or shares. In any of these circumstances and by a certain date, there will be a deemed change in the proportionate equity share interests (as simplifying assumption). Therefore, all distributions with an optional election will be deemed to be a taxable dividend (also giving rise to a corresponding CTC increase).

Example:

Facts: Company X has 1 million shares outstanding. Company X announces a distribution of one share for every two shares held. The value of each distributed share is R50. Company X grants shareholders an option to receive cash instead of shares before a specified date. Shareholder A has 400 shares. Pursuant to the announcement, the Shareholder A receives the shares (i.e. fails to utilise the option for cash).

Result:

The 200 shares gives rise to a taxable dividend of R10 000 (i.e. 200 multiplied by R50) due to the cash option. The CTC in respect of all the Company X ordinary shares should be increased by R10 000.

Proportionate change in share rights

Proportionate share interests within a company can be changed without a share distribution through more indirect means. For instance, a company could change the preferences, limitations, rights or other terms associated with certain shares so as to

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trigger a change of proportionate interests. For instance, the proportionate interest can arise from changes in conversion ratios, redemption prices or differences between the redemption price and issue price. In these circumstances, the value change in the rights will be deemed to be a taxable dividend (and give rise to a corresponding increase in CTC in respect of the shares associated with the enhanced rights).

Effective date

This amendment comes into effect on a date set by the Minister by notice in the Gazette, which date must be at least three months from the date of notice (see clause 56(2) of the 2008 Revenue Laws Amendment Act).

3.7. DIVIDENDS TAX: DEEMED DIVIDENDS

[Applicable sections: 64O; 64P; and 64Q]

Background

The Secondary Tax on Companies (“STC”) is a separate tax from normal (income) tax. Liability for STC falls upon a domestic distributing company when dividends are declared by that company. Deemed dividends also trigger STC when a domestic company enters into certain transactions with a shareholder (or a connected person in relation to that shareholder). Most notably, a deemed dividend can arise from: (i) a company loan, advance or debt; (ii) cross-border over-payments and underpayments subject to section 31 transfer pricing adjustments; (iii) the movement of a domestic company’s tax residence to a foreign location; and (iv) payments of interest viewed as dividends in respect of hybrid debt instruments.

The deemed dividend rules contain a number of exemptions. These exemptions include, amongst others: (i) amounts viewed as remuneration, (ii) loans with an interest rate of not less than the “official rate of interest”, (iii) intra-group transactions, and (iv) transfers to controlled group companies.

Reasons for change

With the advent of a new Dividends Tax, a whole new set of additional deemed dividend rules will be required to act as a backstop for the new tax. Firstly, the new rules have to account for the fact that the new Dividends Tax is imposed at a shareholder-level as opposed to a company-level. Secondly, the new rules have to account for the practical realities of a withholding system.

Proposal

A. Overview

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The new Dividends Tax will contain a back-stop for transactions viewed as “deemed dividends.” Transactions viewed as “deemed dividends” will be subject to the new Dividends Tax along with many of the same or equivalent features as an actual dividend.

The new deemed dividend rules will be similar to the “deemed dividend” rules contained within the STC but will be slightly more narrow in scope. The current deemed dividend rules are sometimes too broad, thereby creating deemed dividends when the commercial realities of the transaction dictate that the transaction should be respected. The new deemed dividend rules also have to cater for the shareholder-level nature of the tax, especially in terms of practical administration.

B. Imposition triggers

Certain transactions undertaken by a domestic company will be viewed as a “deemed dividend.” Deemed dividends will be deemed to be domestic dividends (i.e. will fall under (a) of the definition, thereby becoming subject to the new Dividends Tax under section 64E. These deemed dividends will also be subject to the same exemptions as domestic dividends under section 64F.

Transactions to be described as “deemed dividends” fall into four categories. These categories are as follows:

Loan, debt or advance granted to a connected person: Loans made by a domestic company to a recipient will be viewed as a deemed dividend if the recipient is a connected person in relation to the lending company. For purposes of this test, listed shares will be disregarded in determining whether the company and the recipient are connected persons.

The deemed dividend will be equal to the full principal of the loan. Moreover, the deemed dividend is treated as “paid” when the loan is “made available” to the recipient and the deemed dividend is viewed as being paid directly to the recipient.

Example:

Facts: Company X makes a loan to Shareholder A with a principal of R100 000. Shareholder A owns 60 per cent of Company X.

Result: In the absence of applicable exemptions, a deemed dividend is deemed exist in favour of Shareholder A. Company X must withhold a Dividends Tax of R10 in respect of the loan.

2. *Section 31 over-payments and under-payments:* This deemed dividend trigger applies when a domestic company becomes subject to a section 31 transfer pricing adjustment in respect of a cross-border transaction. More specifically, a deemed dividend will arise if the domestic company sells goods, services or rights to foreign persons for amounts that are less than the section 31 value. A deemed dividend will also arise if the domestic company incurs expenditures in relation to goods, services or rights provided by foreign persons for amounts that are greater than the section 31 value.

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Adjustments in either direction give rise to a deemed dividend. The deemed dividend is viewed as “paid” by the domestic company to the section 31 foreign counter-party on date the taxpayer is notified by SARS of the adjustment.

Example:

Facts: Parent Company owns 100 percent of the shares of Company SA and Company FC. Company SA is a resident, and Company FC is not a resident. Company SA sells some of its manufacturing products to Company FC for R2 million. The price charged to the public by Company SA for comparable products is R5 million. SARS later adjusts the price to reflect the full R5 million value (increasing the price by R3 million) and notifies Company SA.

Result: A deemed dividend is deemed paid by Company SA in respect of the discounted sales to Company FC. The dividend amount equals R3 million and the deemed payment is viewed as made to Company FC.

3. *Company ceasing to be a resident by virtue of a change in effective management:* A deemed dividend is deemed to arise when a domestic company shifts its tax residence to a foreign location (i.e. effective management is shifted to a foreign location without a change in incorporation). The deemed dividend equals the total net value of the company (total value of company’s gross assets less total liabilities).

The deemed dividend is viewed as “paid” from the domestic company to a person who is not a resident and who is not a shareholder in the former domestic company. The payment is deemed to occur at the time of the cessation.

Example:

Facts: Company M decides to relocate all its operations to Country X. Country X has an income tax treaty with South Africa. The treaty provides a reduced tax treaty relief of 5 per cent if there is a shareholding of more than 20 per cent in the paying company.

At the time of the relocation, Company X has assets with a gross value of R100 million. Company X also has liabilities of R60 million.

Result: The relocation triggers a R40 million deemed dividend under the new Dividends Tax. Treaty relief is not applicable because Company X does not own shares in itself.

4. *Interest under section 8F:* The interest “paid” in respect of section 8F hybrid instruments will be viewed as deemed dividends when “incurred” by the paying company.

Example:

Facts: Company XYZ raises funds for its operational requirements by issuing a corporate bond to institutional investors. The terms of the bond issue are that institutional investors are offered an option to convert their rights to the bond issue to shares in Company XYZ at any stage from date of bond issue. Company XYZ pays R30 million per annum in interest to the investors. The term of the bond is five years.

Result: The total interest incurred by Company XYZ will on the bonds is deemed dividends, and will be subject to dividends tax at 10 per cent. Company XYZ therefore is liable to dividends tax of R3 million per annum.

C. Exemptions

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As discussed above, deemed dividends will be subject to the same exemptions from the Dividends Tax as dividends paid by domestic companies. In addition, “loans, advances or debts” otherwise treated as deemed dividends will not be so treated if any of the following exist:

The loan, advance or debt is incurred for the provision of goods, services or rights in respect of the ordinary course of a trade carried on by the lending domestic company. However, this exception does not apply if the transaction is based on more favourable terms to the connected person than a member of the public in similar circumstances (other than a shareholder or an employee).

The loan, advance or debt arises by a company in respect of the business of money lending. However, this exception does not apply if the transaction is incurred on more favourable terms to the connected person than a member of the public in similar circumstances (other than a shareholder or an employee).

The loan, advance or debt has a yield that does not fall below the “prescribed rate” (as defined in section 1 (b) of the Act) throughout the instrument’s term.

The loan, advance or debt is made to a company that is a controlled foreign company (“CFC”). The domestic company lender need not have any interest in the CFC.

The loan, advance or debt is viewed as a donation, remuneration or otherwise giving rise to ordinary revenue for the recipient.

D. Withholding

The withholding rules for deemed dividends will be patterned after the revised for actual dividends paid by a company in restrictive shares, but the deemed dividend withholding rules will be slightly more restrictive. The paying (e.g. lending) company will be subject to withholding on the full amount (new subsection 1). Recipients (e.g. debtors receiving the loan) may claim the section 64F (1) type exemptions (note: the type of loans not qualifying as deemed dividends won’t trigger the initial withholding in the first instance).

Recipient claims for exemption will be modeled after the actual dividend rules in respect of certificated shares, except that claims for exemption must be made per transaction. Foreign parties seeking treaty relief must similarly make their claims per transaction.

E. Effective date rules

No special rules are required for effective dates. Under the law as currently devised, the Dividends Tax does not apply to dividends declared before the effective date. Under the STC, dividends are deemed declared, thereby implicitly bringing in the currently-formulated effective date rules.

F. Contributed tax capital

The new Dividends Tax has no bearing on the company payor’s CTC. CTC cannot be used to offset a deemed dividend nor do deemed dividends provide any increase in CTC.

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Effective date

This amendment comes into effect on a date set by the Minister by notice in the Gazette, which date must be at least three months from the date of notice (see clause 56(2) of the 2008 Revenue Laws A

3.8. COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

[Applicable sections: Sections 1(j) of the “**dividend**” definition), 1(k) of the “**gross income**” definition; 10(1)(iA), and 10(1)(k)(i)(bb); *collateral* sections 6quat(1A)(e), 10(1)(h), 10(1)(i)(xv)(bb), 64B(3A)(b) and 64B(5)(j)]

Background

A collective investment scheme (“CIS”) in shares (formerly referred to as a unit trust) is an investment vehicle operating on behalf of portfolio unit holders. Although technically treated as a company for Income Tax purposes, a number of rules exist to ensure that the CIS is effectively free from tax at the CIS level. When receiving ordinary revenue, the amount received by the CIS will be exempt from income tax as long as the CIS distributes that amount (with the generic trust deed requiring the distribution to occur within 12 months of receipt). Capital gains of the CIS are simply exempt (and are in practice, not distributed).

Portfolio unit holders of a collective investment scheme are generally viewed as receiving taxable dividends when the CIS distributes ordinary revenue to those unit holders. The unit holders also receive capital gains when disposing of those units to other parties (or when surrendering those units back to the CIS if the CIS is distributing capital growth in exchange).

Reasons for change

A distribution by a CIS out of ordinary revenue is treated as a taxable dividend without reference to the underlying character of the amount giving rise to that distribution. However, special provisions often exist that indirectly allow flow-through benefits. For instance, if a CIS receives interest and distributes that amount to foreign unit holders, the foreign unit holders receive exemption as if those holders had directly received the interest. Domestic unit holders that receive amounts derived from interest similarly enjoy the annual interest exemption (currently set at R21 000 below age 65 and at R30 000 at age 65 and above) as if the interest were earned directly.

The difficulty with the current paradigm is that the special provisions just described do not always exist. In effect, haphazard omissions trigger dividends when this tax treatment is inappropriate. For instance, long-term life insurance companies receive one form of allocation under the four funds deduction formula when dividends are received; whereas, interest produces a different result. However, no special provisions exist to treat dividends as interest for purposes of the formula even though the underlying amounts represent a CIS distribution derived from interest.

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Proposal

It is proposed that revenue distributions from a CIS in securities follow conduit/flow-through principles roughly akin to a trust. Deemed dividend treatment in respect of a CIS distribution derived from ordinary revenue will be eliminated (even though a CIS in securities will otherwise retain its deemed character as a company).

Stated differently, ordinary revenue distributions by a CIS in securities will be treated as if the underlying amounts (e.g. interest and foreign dividends) received by the CIS will flow directly to the CIS unit holders. If a distribution is made to multiple unit holders and the distribution contains amounts derived from multiple sources of revenue, these sources of revenue are allocated pro rata.

Flow-through treatment, however, will apply only if the ordinary revenue received by the CIS is distributed to its unit holders within one year after the ordinary revenue is received by the CIS. This one-year limit is consistent with the terms contained in the CIS generic trust deed. If the CIS fails to act within this one-year time limit, the CIS will be taxed on the ordinary revenue as if received and accrued at the close of the one-year period. Subsequent distributions to CIS unit holders of these taxed amounts will be free from additional tax.

Example:

Facts: In 2010, CIS receives R3 million of ordinary revenue from the following sources: (i) R1 million from local interest, (ii) R1 million from local dividends, and (iii) R1 million from foreign dividends. The CIS has various unit holders, including: South African individuals, South African companies and foreign companies. All amounts received by the CIS are distributed within six months after receipt (in accordance with the CIS trust deed). Assume all distributions pre-date the new Dividends Tax.

Result: The underlying sources of the R3 million amount are allocated equally among the unit holders (i.e. 1/3rd local interest, 1/3rd local dividends and 1/3rd foreign dividends). These amounts are proportionally allocated to each unit holder as if received directly. Hence, South African individual unit holders can use the annual interest exemption against the allocable interest, and foreign company unit holders can receive the allocable interest tax-free. South African company unit holders are eligible for Secondary Tax on Company credits (see section 64B(3)) in respect of allocable local dividends. In terms of CIS distributions stemming from foreign dividends, both South African individual unit holders and South African company unit holders are eligible for section 6quat rebates. Foreign company unit holders are free from tax in terms of allocable foreign dividends because foreign-to-foreign transactions are largely outside South African taxing jurisdiction.

Whilst the CIS will generally lose its identity as a company under the revised regime, the CIS will retain its company status for two limited purposes. Firstly, the CIS will be deemed to be a company for purposes of the “connected person” standard because the “connected person test for trusts is too broad (i.e. all trustee beneficiaries are connected, meaning that all CIS unit holders would otherwise be connected). The CIS will also be treated as a company for reorganisation purposes so that the CIS can remain eligible for Part III rollover treatment.

Effective date

The amendment applies in respect of distributions made on or after the date the Taxation Laws Amendment Bill is promulgated by the President.

3.9. TELECOMMUNICATIONS LICENSE CONVERSION

[Applicable sections: New section 40D; new paragraph 67D of the Eighth Schedule]

Background

Generally, the capital gains tax is levied on the disposal of a capital asset. A capital asset is broadly defined and includes a license which in essence, constitutes property of an intangible nature. The term “disposal” is similarly broad in nature, covering any variation in rights.

Reasons for change

Telecommunications licenses are regulated by the Independent Communications Authority of South Africa’s (ICASA). Under the current system, the old telecommunications licenses were technologically specific. This meant that the services which mobile telecommunications service providers offered were mutually exclusive from the services provided by non-mobile telecommunications service providers. In an effort to promote a more open and competitive environment, ICASA has sought to eliminate the system of exclusive rights granted to certain telecommunications companies for the provision of fixed communications or mobile cellular communications. In effect, all licenses will be comprehensive – covering both fixed and mobile telecommunication operations.

This conversion from existing narrow licenses to new comprehensive licenses has occurred pursuant to the direction of ICASA under the broad mandate of section 93 of the Electronic Communications Act 36 of 2005 (“ECA”). The conversions occurred pursuant to Government Gazette 31803 of 16 January 2009. At issue is the tax impact of this required conversion. In particular, this conversion will be subject to capital gains tax because the conversion is a variation in rights. The regulatory nature of this variation does not alter the analysis.

Proposal

The industry-wide conversion under Section 93 of the ECA will no longer be treated as a taxable disposal for capital gains tax purposes. The conversion is outside the control of the relevant parties and re-arranges telecommunication rights for the industry as a whole. The conversion should instead be viewed as a rollover event (with the tax attributes of the existing licenses generally rolled over into the new licenses) so that all gains and losses are deferred until the converted licenses are subject to a subsequent disposal.

More specifically, rollover treatment will be achieved by creating a dual set of rules (one for capital gains purposes and the other for depreciation purposes under the normal tax). Both sets of rules will cover a simple conversion of an existing license to a new license as well as the conversion of multiple existing licenses to a new license and the conversion of a single license into multiple licenses. No provisions are necessary for telecommunications licenses as trading stock.

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1. *No capital gain/loss:* The disposal of existing licenses caused by the conversion will be deemed to occur at an amount equal to the pre-existing base cost. This deeming rule eliminates all capital gain or loss.
2. *No recoupment for depreciable licenses:* Even if the existing license was subject to amortisation (i.e. under section 11(gD) as added by the 2008 Revenue Laws Amendment Act), the conversion will not trigger any recovery or recoupment.
3. *Expenditure capital gains tax/depreciation cost rollover:* The expenditure incurred in respect of an existing license is deemed to be the expenditure incurred for the converted license. If multiple existing licenses are converted, the expenditure of all these licenses is aggregated for purposes of the converted license. If a single license is converted to multiple licenses, the expenditure for these licenses is split pro rata based on the relative values of the new licenses. Comparable rules exist for depreciation cost under the normal tax.
4. *Timing rules:* The timing rules for each existing license cannot be combined without adding serious complexities. Therefore, unlike the company reorganisation rules, the expenditure to acquire the converted license is deemed to be incurred immediately after the required conversion. The net impact of this rule is to eliminate the various 2001 capital gains effective date rules (e.g. valuation and time-apportionment). On a similar note, all converted licenses are depreciable (under section 11(gD)) with a useful life beginning from the date of conversion.

Example.

Facts. Telecommunications Company owns two existing telecommunications licenses – Pre-existing License A and Pre-existing License B. Pre-existing License A was acquired for R40 million on 1 April 1998 and has a useful life of 15 years. Pre-existing License B was acquired for R80 million on 1 January 2008 and has a useful life of 20 years. In 2008, R4 million is claimed as a depreciation allowance in respect of Pre-existing License B. On 16 January 2009, both licenses were converted into new Combined License under section 93 of the ECA. The new license has a 20-year useful life.

Result. The section 93 conversion does not trigger any capital gain or recoupment. Combined License has a capital gains expenditure (and a depreciable cost) of R116 million (R40 million plus R80 million less R4 million). The depreciation of the R116 million amount is based on a 20-year useful life starting from the point immediately after conversion (i.e. immediately after the 16 January 2009 conversion).

Effective date

This amendment will apply to telecommunications license conversions occurring on or after 1 January 2009.

3.10. INTERNATIONAL SUBMARINE TELECOMMUNICATIONS CABLES

[Applicable sections: Amendment to Sections 11(f) and 12D]

Background

Factual background

South African communications companies are seeking to obtain access to an international submarine telecommunications cable ("submarine cable") situated on the coasts of Africa. This cable is currently controlled by foreign persons. South African access to this cable will enhance the quality of domestic telecommunications services and also reduce the high bandwidth costs that currently exist in the South African market.

Parties interested in participating in the cable may either obtain joint ownership in a submarine cable or an indefeasible right of use ("IRU") in the submarine cable. Capacity access in privately owned submarine cable arrangements is usually obtained on an IRU basis; while capacity access in partnership arrangements is usually obtained by joint ownership (i.e. the ownership percentage is equal to the capacity ownership). The IRU arrangement is by far the most common form of obtaining access to a submarine cable.

An IRU is a right to use capacity in a submarine cable without ownership. The IRU holder is generally required to contribute an upfront capital premium and to pay ongoing amounts for the operation and maintenance of the cable during the lifetime of the cable. International accounting standards generally view an IRU as a right of use; whereas, U.S. accounting standards view an IRU as a service. An IRU typically has a 20-year term.

Applicable tax provisions

Taxpayers generally may deduct a 5 per cent allowance in respect of the cost incurred to acquire new and unused section 12D "affected assets." Affected assets include a telephone line or cable used for transmitting telecommunication signals. Affected assets within the allowance must be new and unused.

Special rules apply to determine the deduction of an allowance in respect of a premium or consideration of a similar nature paid for the right of use of certain tangible and intangible assets. The allowance is spread proportionately over the shorter of (i) the useful life of the right of use or occupation of the asset or, (ii) 25 years. The allowance is not allowed if the payment is tax-exempt in the hands of the recipient.

Reasons for change

The above interests in a submarine cable do not appear to be deductible over time. This lack of a deduction makes little sense because a write-off is warranted given the economic depreciation over time. This economic depreciation is fully recognised by international accounting standards.

Joint ownership interests in submarine cables presumably are not deductible because these interests fall outside the term "affected assets" under section 12D. The term "affected asset" is limited to a "telephone line or cable used for transmitting telecommunication signals." IRUs are not deductible because the recipient of the premium are foreign persons in respect of foreign sourced income (i.e. the income is exempt in the hands of the recipient).

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Proposal

It is proposed that section 12D should be amended to provide for a deduction of an allowance in respect of the cost of acquiring electronic communication lines or cables for direct joint ownership. This write-off will be set at 5 per cent per annum.

It is also proposed that the deduction for a premium in respect of an IRU be allowed even though the income is exempt in the hands of a foreign recipient. However, this allowance applies only if the IRU has a legal term of at least 20 years. This deviation from the exempt recipient prohibition is added because little avoidance exists given the 20-year spreading of the deduction and because the premium provides the same result as the 5 per cent depreciation write-off for owned assets. While the exempt prohibition in section 11(f) remains important to prevent anti-avoidance, it has come to Government's attention that the prohibition is overly broad, thereby giving rise to unintended anomalies. This prohibition will have to be revisited in the near future.

Effective date

The amendment is effective for all assets or rights of use acquired on or after 1 January 2009.

3.11. IMPROVEMENTS ON LEASED GOVERNMENT LAND

[Applicable section: Section 11(g)(vi)]

Background

If a lessee makes improvements in respect of land or a building owned by the lessor, the lessee can deduct the improvement over time. More precisely, the cost of the improvement is generally deductible over the lessee's right of use or occupation (with a 25 year maximum). These improvements also trigger gross income for the lessor the tax on which the improvements effected.

However, the deduction for the lessee does not apply if the improvement does not constitute income for the lessor (for instance, if the lessor is tax-exempt). The only exception to this prohibition of deductions is for improvements effected pursuant to a Public Private Partnership agreement.

Reasons for change

The various spheres of government (especially municipalities) often seek to have improvements effected on their land as a means of upgrading infrastructure. This form of upgrade is typically effected through the use of a lease arrangement, even though government is exempt from tax (thereby preventing the lessee from deducting the improvements).

While the prohibition against deducting improvements for exempt lessors exists to prevent avoidance, the prohibition is undermining other governmental objectives. The need for changing the prohibition in this regard has already been recognised by allowing

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for the deductibility of improvements in the case of Public Private Partnership agreements.

Proposal

The prohibition against deducting improvements for exempt lessors will no longer apply if: (i) the lessor is leasing land or buildings owned by government (national, provincial or municipal), and (ii) the lease is of a duration of 20 years or more. The 20-year rule prevents taxpayers from artificially converting ownership to leasing (e.g. via sale-leasebacks) in order to indirectly shorten the depreciation period (which usually has a 20-year period for most buildings). The prohibition against exempt payees (like the comparable prohibition against deducting premiums paid to an exempt lessor) needs to be revisited in the near future.

Effective date

The proposed amendment will be effective for lease agreements (requiring the effecting of improvements) entered into on or after 1 January 2009.

3.12. DEPRECIATION ON IMPROVEMENTS

[Applicable sections: Sections 11D, 12B, 12C, 12D, 12F, 12I, 24G and 37B of the Income Tax Act]

Background

Many provisions within the Income Tax Act provide for an annual depreciation allowance in respect of assets. Many of these provisions cover both underlying assets as well as improvements.

Reasons for change

The specific language in the depreciation rules is inconsistent in so far as improvements are concerned. Some of the rules specifically provide for a depreciation allowance in respect of improvements whilst others do not. A further problem is the inconsistent treatment of depreciation for improvements in the sections that do explicitly provide for the allowance. For instance, the depreciation allowance for improvements sometimes lacks the “new and unused” requirement. In other cases, the eligibility of the improvement is linked to the “new and unused” nature of the underlying asset.

Proposal

In order to facilitate consistency, the proposed amendments will clarify that the depreciation allowance equally applies to improvements associated with underlying assets. Depreciation of improvements should be determined as if the improvement were a stand-alone asset. For instance, if the depreciation provision at issue requires the underlying asset to be “new and unused,” the improvement itself must be “new and

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unused” if that improvement is to be depreciable (but the improvement need not be associated with a “new and unused” underlying asset).

Effective date

The above amendments are effective for expenditures incurred in respect of years of assessment ending on or after 1 January 2010 (i.e. the general effective date).

3.13. ADJUSTING RING-FENCING OF LOSSES FOR FINANCIAL LEASING

[Applicable section: 23A]

Background

The Income Tax Act provides depreciation allowances or deductions for various business assets and expenses. Losses arising from these items may be set off against the taxpayer’s income derived from trade or other income. If the losses exceed income, the losses are carried forward to a subsequent year and are set off against income derived in that year.

Section 23A of the Income Tax Act limits the amount of deductions that may be set off against taxable income from letting certain depreciable assets, e.g. plant, machinery, rolling stock and aircraft (“affected assets”). Depreciable assets let in terms of operating leases are not affected assets and the limitation does not apply to them (i.e. the provision mainly applies to financial leases).

Reasons for change

Depreciation deductions in terms of section 23A can only be offset against “rental income.” The set-off of assessed losses against any other income (including income from proceeds from the sale of affected assets) is not allowed. As a result, assessed losses in the case of a sale are often permanently lost. This runs counter to the underlying policy, which is solely to ensure that excess financial leasing losses are not used against income from other activities (as a form of passive temporary tax-shelter). Stated differently, section 23A ring-fencing is designed to prevent timing benefits, not to prevent deductions outright.

Proposal

Excess depreciation losses from the lease of “affected assets” can now freely be used against the income associated with those assets. In other words, ring-fenced losses should be fully permitted against trade associated with the leased assets, including—

1. any recoupments in terms of section 8(4) when disposing of affected assets; and
2. any capital gains realised on the disposal of affected assets.

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Effective date

This amendment comes into effect for use of the assessment ending on or after 1 January 2009 and applies to disposals occurring on or after that date.

3.14. CROSS-ISSUE AVOIDANCE – REMEDYING UNINTENDED ANOMALY

[Applicable section: 24B(2C)]

Background

When a company issues shares as consideration for assets, the company is generally treated as having incurred an expenditure equal to the lesser of: the assets received or the issued shares (both of which are measured at their post-transaction value). However, if a company issues its own shares for the issue of shares by a second company, both companies will be deemed not to have incurred any expenditure.

The difference in both scenarios stems from the fact that the former scenario typically gives rise to tax; whereas, a dual issue of shares is tax-free. Tax expenditure should arise only to the extent the transaction contains pre-existing tax-recognised expenditure or tax is recognised in the transaction. In the case of a cross-issue, the newly issued shares start with a zero expenditure (e.g. base cost), and no tax is recognised in the transaction.

Reasons for change

The prohibition against cross-issues has long contained rules to prevent taxpayers from adding steps or parties in order to artificially side-step the prohibition. For instance, if a company issues shares for cash from a second company with the second company simultaneously issuing shares for cash with the first company, both sets of shares will be deemed to have zero expenditure. Similarly, if a company issues shares to a second company in exchange for the second company issuing shares to a wholly subsidiary of the first company, both sets of shares will again be deemed to have zero expenditure.

In 2008, the technical language seeking to prevent indirect cross-issues was changed to ensure that cross-issues were fully targeted as intended. Under the new language, a cross-issue exists if one company issues shares “by reason of or in consequence of” the issue of shares by another. The only escape hatch from this form of cross-issue is the separation of share issues by more than 18 months.

While this change closed-down a number of artificial schemes that allegedly side-stepped the cross-issue prohibition, the change has created an unintended anomaly when forming a multiple chain of companies. More specifically, assume a person transfers assets in exchange for shares of a newly formed company, and the newly formed company transfers the same assets to a newly formed wholly owned subsidiary, the revised cross-issue allegedly applies to create zero expenditure. This zero expenditure arises because the wholly owned subsidiary is arguably issuing shares “by reason of or in consequence of” the share issue by the first company (i.e. the second share issue would not have occurred but for the first).

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The change to the cross-issue rule was never intended to impact a multiple formation. The assets transferred will typically qualify as recognised tax expenditure (or trigger recognition of tax). Therefore, a specific carve-out will be required.

Proposal

The zero expenditure rule for cross-issues will not apply to transfers down a multiple chain of controlled group companies (i.e. 70 per cent owned subsidiaries). This exception applies on condition that the consideration received by the controlled group company is not used to acquire shares issued by a company other than a lower-tier controlled group company of the controlled group company. If the exception does apply, the controlled group company issuing the shares will instead be viewed as having incurred an expenditure equal to the lesser of: the assets received or the issued shares (both of which are measured at their post-transaction value).

Example

Facts: Individual transfers land to Newco in exchange for shares issued by Newco. Newco then immediately transfers the land to wholly owned Newco Subsidiary in exchange for shares issued by Newco Subsidiary.

Result: Even though the shares of Newco Subsidiary are arguably issued as a consequence of the first share issue by Newco, the exception to the zero expenditure rule for cross-issues applies. Newco Subsidiary accordingly is deemed to have an expenditure equal to the lesser of the land received or the Newco Subsidiary shares issued (both of which are measured after the land-for-Newco Subsidiary transaction).

Effective date

This amendment operates as a technical correction to last year's changes to section 24B (Clause 39(2)). The amendment is accordingly backdated to that date (i.e. coming into operation on 21 October 2008 in respect of shares issued on or after that date).

3.15. LIQUIDATING, WINDING UP OR DEREGISTRATION OF EXCLUSIVE RESIDENCE COMPANIES

[New provision: paragraph 51A of the Eighth Schedule.]

Background

The distribution of assets (including a domestic residence) by a company in a liquidation, wind-up or deregistration to a natural person generally constitutes a disposal for capital gains tax (CGT) purposes at both the company and shareholder levels. The distribution also constitutes a dividend for secondary tax on companies (STC) purposes, and the acquisition of the residence triggers transfer duty for the natural person.

Reasons for change

Prior to 2001, many natural persons utilised companies to hold a domestic residence. This form of holding avoided the imposition of transfer duty without adverse tax consequences. CGT was introduced in 2001, thereby creating a potential dual level charge. The residential property company anti-avoidance rules (introduced in 2002) also eliminated the transfer duty benefits of the company holding structure. STC-free treatment for capital profits was additionally limited to pre-2001 capital profits. In view of these changes, a limited window period was granted to provide the opportunity to transfer a residence out of a pre-existing company structure. This window period eliminated all CGT, STC and transfer duty adverse consequences. This window period has long since expired.

A Companies Act annual fee will be required to be paid by all companies in order to reduce the number of inactive and dormant companies. In light of this new cost, it is anticipated that most taxpayers with homes contained within a company would find a renewed desire to transfer their homes out of these companies into their own individual names. None of these companies has a commercial (non-tax) purpose that will justify the annual fees associated with the use of the company. However, with the above-mentioned window period closed, the liquidation, winding up or deregistration of these companies will result in adverse tax consequences for both the company and the natural person.

Proposal

It is proposed that tax relief be provided for a two-year window period so that companies solely containing a residence used exclusively for domestic purposes (by the individual shareholder or spouse) can liquidate, wind up or deregister tax-free, thereby avoiding the impending company law annual fee. More precisely, the liquidating, winding up or deregistration distribution of the domestic residence should be viewed as a CGT rollover event (with the tax attributes of the residence in the company's hands rolled over into the hands of the natural person). In effect, all CGT gains and losses will be deferred until the residence becomes subject to a subsequent disposal by the natural person. The distribution will also be exempt from STC and transfer duty.

Effective date

This provision will have a 2-year effective date – starting on 1 January 2010 and ending on 31 December 2011. More specifically, the provision will apply to all distributions occurring on or after 1 January 2010 but before the close of 31 December 2011.

3.16. SHELF COMPANY START UPS AND SMALL BUSINESS RELIEF

[Applicable section: Section 12E(4)(a)(ii) and paragraph 3(f)(iii) the Sixth Schedule of the Income Tax Act]

Background

Qualifying companies (and individuals) may account for income tax by using the presumptive tax system. A special income tax dispensation also exists for companies that qualify as a small business corporation. Both dispensations contain a number of preconditions. Of particular note is the anti-multiple shareholding prohibition, which is designed to prevent the splitting of a single large (ineligible) business into multiple small (qualifying) businesses. Under this prohibition, a company is generally prevented from qualifying for either special tax dispensation if their shareholders (or members) hold shares (or have an equity interest) in any other company at any time during the year of assessment. De minimis interests in portfolio equity holdings (and similar interests) have no adverse impact in respect of the prohibition.

Reasons for change

As a theoretical matter, a dormant shelf company should be able to engage in start up operations as a qualifying small business corporation or as a micro business (just like a newly formed company). However, practical realities undermine this objective. When new owners purchase a dormant shelf company, the selling owner of the shelf company typically owns equity in other dormant companies (especially sellers that keep multiple dormant shelf companies on hand). This multiple shareholding by the seller precludes the newly transferred shelf company from qualifying for micro business or small business corporation relief.

Admittedly, the anti-multiple shareholding prohibition only has a one-year impact (i.e. the prohibition applies only during the shelf company's year of assessment in which the shelf company ownership is transferred). However, no policy reason exists for preventing small business relief for this one-year period. The one-year prohibition also means that micro business shelf companies must submit a normal income tax return for one year before being able to utilise the presumptive turnover tax.

Proposal

It is proposed that the micro business and the small business corporation definitions be amended so that the anti-multiple shareholding prohibition does not apply during the initial dormant period of a company's existence. This dormant period exists as long as the company does not trade or hold assets exceeding a value of R5 000. This suspension of the prohibition will remedy the concern outlined above, thereby promoting shelf company start-ups without impacting acquisitions of operating small business companies.

Effective date

The above amendments are deemed to be effective for years of assessment ending on or after 1 January 2010 (i.e. the general effective date).

3.17. OIL AND GAS INCENTIVES AND ANCILLARY TRADES

[Applicable section: Paragraphs 1; 3 & 5 of the Tenth Schedule]

Background

Tenth Schedule Benefits

The Tenth Schedule provides tax incentives to oil and gas companies, such as an additional allowance for exploration and production equipment. The Tenth Schedule also provides an opportunity for companies to enter into a fiscal stability agreement with the Minister of Finance. This fiscal stability agreement freezes the rate of normal tax (and the secondary tax on companies) for oil and gas companies against potential future increases and protects oil and gas companies against the potential future loss of Tenth Schedule benefits. Most aspects of the Tenth Schedule are limited to “oil and gas income” (and income from the refining of gas).

Oil and gas company definition

A qualifying “oil and gas company” must: (i) hold an oil and gas right, (ii) engage in exploration or production in terms of an oil and gas right, or (iii) engage in refining of gas derived in respect of any oil and gas right held by that company. Most notably, a qualifying oil and gas company may not engage in any trade other than the activities just described (such as engaging in foreign oil and gas trades (i.e. oil and gas trades not associated with South African oil and gas rights)). “Oil and gas income” is defined as any receipts, accruals or gains derived by an oil and gas company in respect of an oil and gas right, including the leasing or disposal of that right.

Reasons for change

The “oil and gas company” definition is narrowly defined and takes an all-or-nothing approach. A company engaging in any trade that is not stipulated in the oil and gas company definition prevents the benefits of the Tenth Schedule. This prohibition applies even to ancillary trades normally associated with oil and gas exploration and production. These ancillary trades include the leasing of excess building space, the purchase and sale of oil to cover contractual short-falls and management fees from managing oil and gas joint ventures. No reason exists to prevent the application of the Tenth Schedule merely because a company engages in ancillary trades normally associated with oil and gas exploration and production.

Proposal

The definition of “oil and gas company” should be relaxed so as to eliminate the all-or-nothing approach. The prohibition against impermissible trades will be dropped. Instead, the “oil and gas income” definition will be narrowed so that the benefits of the Tenth Schedule will be strictly limited to oil and gas production (as well as the leasing or disposal of oil and gas rights).

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One collateral consequence of this amendment is to eliminate the special rules for gas refining (a non-exploration and non-production activity normally associated with gas production). The special rules for treating gas refining as a permissible trade will no longer be necessary because non-exploration and non-production activities will now be permitted. Gas refining will be permitted like any other non-exploration and non-production activity (nor will gas refining specifically receive any special Tenth Schedule benefit).

Effective date

The amendment is effective for years of assessment ending on or after 1 January 2010 (i.e. the general effective date).

3.18. VENTURE CAPITAL COMPANY REFINEMENTS

[Applicable section: 12J]

Background

In 2008, an investment incentive was added to the Income Tax Act that seeks to encourage retail investment in VCCs that are mainly directed toward investments in smaller businesses and junior mining companies. In order to qualify as a VCC, the company must meet requirements as to form, structure and allocation of expenditures, amongst others.

All of the requirements just-described demand upfront approval from SARS. However, certain requirements must be satisfied immediately while others need not be satisfied until 36 months after approval. The 36-month deferral period provides newly-created VCCs time to find suitable investment expenditures relating to smaller businesses and junior mining companies.

Reasons for change

The upfront SARS approval process for VCCs is impractical when read in conjunction with the 36-month deferral period. SARS cannot be expected to provide upfront verification as to whether a particular company will satisfy various investment expenditure allocation requirements after a 36-month period. Satisfaction of the post-36 month verification requirements can only be determined after the 36 month period begins. Review of the incentive has also revealed other smaller anomalies.

Proposal

Revised framework for SARS approval and withdrawal

The SARS approval process for the VCC incentive will be revised to eliminate the predictive aspects currently required of SARS. More specifically, SARS will only be required to provide upfront approval of the form, structure and other aspects of the VCC that can be determined from the beginning. SARS will no longer be required to provide upfront approval of the investment expenditure allocation requirements. Instead, failure to

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satisfy the investment expenditure requirements will only be taken into account from the 36-month period onward (see below).

B. Revised upfront SARS approval requirements

Under the revised system, SARS will approve a company as a VCC under the following conditions—

- (a) the company is a South African resident;
- (b) the sole object of the company is the management of investments in qualifying companies;
- (c) the company's shares are unlisted;
- (d) the company is not more than 50 per cent controlled by another company;
- (e) the company's tax affairs are in order;
- (f) the company (together with any connected person) may not control any qualifying (small business or junior mining) investee company; and
- (g) the company must be licensed in terms of section 7 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002).

These requirements are essentially the same as existing law with one new requirement pertaining to the sole object of the VCC as a manager of qualifying investments. The purpose of this rule is to ensure that deductible investment into the VCC is not misdirected given the elimination of certain other requirements. It should be noted that the VCC can still engage in other activities ancillary to its sole purpose (such as the leasing of excess office space or investing in short-term debt instrument or preferred shares for temporarily liquid capital).

In addition, the prohibition against non-qualifying company income has been slightly relaxed. Under the revised rule, no more than 20 per cent of the gross income of the company can be derived from (i) financial instruments (excluding non-qualifying shares) or (ii) services rendered to a qualifying (small business or junior mining investee) company. The revised 20-per cent range (as opposed to the previous 10-per cent range) is more in line with the 80-per cent require expenditure rules (see below). Moreover, satisfaction of this rule no longer requires upfront SARS approval. This rule only comes into play upon subsequent violation, thereby triggering a subsequent withdrawal (before or after the 36-month period).

Revised activation of the 36-month requirements

As under current law, the investment expenditure requirements apply only from the 36-month period after the formation of the VCC. However, SARS will no longer be required to provide upfront approval in this regard. Instead, SARS will be required to withdraw approval from the 36-month period onward to the extent the VCC fails to satisfy the investment expenditure requirements. The requirement that the VCC must commit at

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least 10 per cent of its expenditure to a company with a book value not exceeding R5 million was also dropped.

Removal of deferred investee company requirements

The rules for qualifying investee companies also contain certain requirements that are triggered only after an 18-month deferral period (or after 36 months in the case of junior mining investee companies). These requirements also create problems for SARS given their predictive nature. In order to remedy these deficiencies, these predictive aspects will be removed.

The investee company will no longer have to be engaged in a trade (other than an impermissible) within 18/36 months after the VCC's investment. Henceforth, the investee company must simply not be engaged in an impermissible trade. Secondly, the investee company will no longer be required to spend the sums received from the VCC within an 18/36 month period. Only the prohibition against passive income exceeding 20 per cent of the investee company's total gross income will apply from the moment of the VCC investment. On its own, the 20-percent prohibition effectively prevents VCCs from investing in passive companies (without resort to the deleted requirements).

Permissible listed company investors

Under current law, listed companies (and section 41 group company members) may receive a deduction for their VCC investments up to 10 per cent of the equity shares in the VCC. Any excess investment is permitted but not deductible. The purpose of this 10 per cent requirement is to ensure diversification in VCC ownership.

The proposed amendment increases the percentage limit to 40 per cent. The purpose of this increase is to cater for anchor company investors. These anchor investors provide a level of security that act as a catalyst for attracting smaller retail investors.

Effective date

The amendments will be effective from 1 July 2009 (the same date as the VCC incentive as a whole).

4. INTERNATIONAL

4.1. CONVERSION OF THE CONTROLLED FOREIGN COMPANY (CFC) RULING EXEMPTIONS

[Applicable sections: 9D (1) ("business establishment"), (2A) and 9D (10)]

Background

Section 9D is an anti-avoidance provision that is generally aimed at preventing South African residents from shifting tainted forms of taxable income outside South African taxing jurisdiction by investing through a CFC. The main targets of concern are mobile (passive and business) income as well as diversionary foreign business income (i.e. suspect structures that can easily lead to transfer pricing avoidance). As a general rule, the net "tainted" income of a CFC is attributed to and included in the taxable income of

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South African shareholders. The main category of income falling outside of the “tainted” categorisation relates to amounts attributable to a foreign business establishment of the CFC.

In 2006, a special rulings system was introduced to provide SARS with the authority to grant various waivers from “tainted income” treatment on a case-by-case basis (with the purpose of properly balancing commercial practices against objective avoidance rules). The rationale for this special rulings system was to create a series of informal rules on a case-by-case basis so as to obtain more facts that would later be developed into objective legislation. More specifically, this section empowers SARS to issue rulings that:

1. Allow aggregation of related CFC group structures and employees as well as equipment and facilities for purposes of the foreign business establishment rule;
2. A diversionary transaction waiver for centrally located operations;
3. A diversionary transaction and passive income waiver for high taxed income; and
4. A foreign financial instrument holding company waiver for services that are comparably taxed between two foreign countries.

Reasons for change

The problem with the special rulings process for CFCs is that SARS is an administrative agency, not a policy body. The special rulings tend to border more on the latter. In addition, as stated above, the special ruling process was designed to be a short-term solution for gathering facts that would assist in drafting appropriate legislation. In the process of gathering the facts, the following anomalies have been identified:

1. The foreign business establishment contains defects giving rise to the potential for tax avoidance;
2. The foreign business establishment test needs refinement with regard to the group company sharing (of structures and employees, as well as equipment and facilities;)
3. The high-taxed income rulings exemption needs further refinement in terms of simplicity and anti-avoidance;
4. The foreign financial services rulings exemption has never been utilised since its inception in 2006, thereby raising the question of whether this waiver is superfluous; and
5. The special rulings process for CFCs creates administrative difficulties in respect of compliance and enforcement.

Proposal

The main purpose of the amendment is to merge the special CFC rulings exemptions into the objective legislation in order to remedy the problems just described.

Foreign business establishment definition

In the main, the foreign business establishment definition will be clarified and tightened to ensure that the foreign business establishment relied upon is economically meaningful. The definition will be revised so as to open with the conceptual framework. Under this opening framework, a foreign business establishment must consist of a fixed place of business located in a country outside the Republic as long as the business is carried on

continuously or regularly at that location (e.g. as opposed to occasional sales). In making this determination, the legislation will contain three components relating to the nature of the business and a fourth relating to purpose.

In terms of components, the fixed place must have structure and employees as well as equipment and facilities are largely the same as the current rule with a few minor modifications. For instance, the law will be clarified to ensure that these components are located in the same country as the fixed place of business. However, the “full time basis” rule for employees will be dropped in view of the “continuously or regularly” requirement within the revised opening framework.

As for the final component, the current “bona fide” test will be replaced. Under the present formula, a bona fide business non-tax purpose is sufficient even if that purpose is de minimis in relation to the tax consequences. Under the new formulation, the business purpose must be the sole or main reason that the fixed place of business is located in the country at issue. In addition, the purpose must be a non-tax purpose, meaning that the intent to avoid either South African and foreign tax will be disregarded. While the CFC rules are largely concerned with the avoidance of South African tax, practical realities dictate that the separation of domestic from foreign tax in respect of business is unrealistic. CFC structures typically seek to avoid taxes from multiple countries.

As a final matter, the revised foreign business establishment definition allows for certain activities for foreign controlled companies to be taken into account without reliance on a SARS ruling. More specifically, qualification of a fixed place of business of a CFC as a foreign business establishment allows for structures and employees as well as equipment and facilities of another CFC to be taken into account if:

1. those items are located in the same foreign country and are associated with that business;
2. the other foreign controlled company must be incorporated in the same country as the fixed place of business at issue; and
3. the other CFC must be part of the same section 1 “group of companies” (i.e. have a 70 per cent share linkage) as the CFC at issue.

High-taxed CFC net income exemption

The special rulings process for high-taxed controlled foreign companies will be merged into objective legislation. Stated differently, controlled foreign companies will be deemed to have a “net income” of zero if viewed as high-taxed (thereby eliminating all South African taxation). The purpose of the revised high-taxed exemption (like the prior exemption within the special rulings process) is to disregard tainted CFC income if little South African tax is at stake once South African (section 6quat) tax rebates are taken into account. Unlike the rulings exemption, the new exemption exempts all CFC income (not merely passive and diversionary income).

To be viewed as high-taxed, the CFC must be subject to a rate of tax of at least 20 per cent by the national sphere of government in which that CFC is incorporated. In addition, the “net income” of the CFC as an aggregate must be subject to a global level of foreign tax of at least 75 per cent of the amount of tax that would have been imposed had the CFC been fully taxed in South Africa. The 75 per cent threshold matches the U.K. CFC (i.e. the threshold of South Africa’s biggest investor). For purposes of this 75 per cent threshold, the global-level of tax takes into account foreign taxes on income imposed by all foreign spheres of government (national, provincial and local). This global

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amount also takes into account all income tax treaties, rebates, credits or other rights of recovery but not assessed losses.

Financial services rulings exemption

The special ruling provisions relating to financial services waiver will be deleted due to the lack of use. This waiver is also inconsistent with CFC anti-avoidance philosophy as a whole (because the tax comparison is based on a comparison of foreign country taxation without regard to the hypothetical South African tax).

Diversionsary income rulings exemption

Going forward, the only remaining item within the special CFC rulings process is the exemption for otherwise taxable diversionsary transactions. No change is envisioned in this area at the present stage until further information can be obtained.

In terms of this remaining rulings area, the timing of the rulings request will be clarified. In order to obtain rulings relief, the relevant parties must submit their application for relief before the close of the year of assessment (i.e. requests for retroactive relief will not be granted). This change ensures that the rulings waiver does not interfere with the normal audit process.

Effective date

The proposed amendments will generally be effective for tainted CFC income in respect of the CFC's foreign tax arising in the year of assessment ending on or after the date of the Bill's introduction. The changes to the rulings process (including the deletions) will be effective for all applications submitted to SARS on or after the date of the Bill's introduction.

4.2. FOREIGN PORTFOLIO DIVIDENDS

[Applicable sections: 1('listed share' definition):6*quat* and 10(1) (k) (ii)(bb); 64D(1)("dividend" definition); 64F(3); 64N]

Background

Foreign dividends are generally taxed at marginal rates (i.e. up to 40 per cent for individuals and 28 per cent for companies). However, this general rule of taxation contains several exemptions. One exemption exists for foreign dividends declared by foreign companies with a dual listing (one listing on the Johannesburg Stock Exchange and the other listed on a recognised foreign exchange).

Reasons for change

The exemption applicable to foreign dividends of dual listed foreign companies was introduced to ensure that all shares listed on the Johannesburg Stock Exchange were subject to an equal tax playing field (be they domestic or foreign incorporated). With impending dividend tax reform (i.e. the change from the Secondary Tax on Companies to the new Dividends Tax), it is questionable whether the current tax exemption for dual

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listed foreign companies can be maintained without creating a disincentive for domestic dividends (the latter of which will now generally be subject to a 10 per cent charge at the shareholder level).

Proposal

The current exemption for dual listed foreign companies will be eliminated. Foreign portfolio dividends distributed by dual listed companies will instead be subject to a 10 per cent charge pursuant to the new Dividends Tax (similar to the new rule for domestic dividends). In order for this charge to apply, the foreign company shares generating the dividends must be uncertificated shares listed on the Johannesburg Stock Exchange. Dividends from other shares issued by a dual listed foreign company are treated like any other foreign dividend (i.e. taxable at ordinary rates subject to exemptions).

The new Dividends Tax withholding rules for these foreign uncertificated shares will be the same as for domestic uncertificated shares listed on the Johannesburg Stock Exchange. Therefore, withholding in respect of these foreign uncertificated shares will be performed by regulated intermediaries (e.g. central securities depository participants).

Dividends of dual listed foreign companies may also be subject to withholding taxes from the country in which the foreign company is a tax resident. If circumstances of this nature exist, it is proposed that these foreign withholding taxes give rise to tax rebates (i.e. tax credits). These rebates will be useable as an offset against the 10 per cent charge imposed by the new Dividends Tax. Rebates stemming from these foreign withholding taxes may not exceed the new Dividends Tax charge (i.e. 10 per cent).

Rules relating to other foreign dividends will largely remain in place. These other foreign dividends are generally subject to tax at ordinary rates part 4 to pre-existing exemptions.

Effective date

The proposed amendment will be effective along with the new Dividends Tax. Hence, this amendment will come into effect on a date set by the Minister by notice in the Gazette, which date must be at least three months from the date of the notice (see clause 56(2) of the 2008 Revenue Laws Amendment Act).

4.3. REPEAL OF FOREIGN LOOP EXEMPTION

[Applicable sections: 10(1) (k) (ii) (aa) and 64B (3A) (d) of the Income Tax Act]

Background

Foreign dividends are generally taxed at marginal rates (i.e. up to 40 per cent for individuals and 28 per cent for companies). However, this general rule of taxation contains several exemptions. One exemption exists for foreign dividends distributed out of profits that were directly or indirectly subject to tax in South Africa before the distribution.

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Reasons for change

The current exemption applicable to foreign dividends distributed from profits already subject to tax in South Africa was mainly introduced because of the Dividend Access Trust (DAT) mechanism. The DAT was prompted by the Reserve Bank in respect of various South African companies re-domiciling abroad. The purpose of the DAT was to prevent an ongoing outflow of currency from South Africa.

A recent review of the facts relating to the DAT suggests that the exemption for foreign dividends previously subject to direct or indirect South African tax may have been misplaced. Dividends relating to a DAT mechanism never leave South African shores (even momentarily). In effect, the DAT mechanism utilises a mix of domestic preference subsidiary share dividends (paid through both a domestic special purpose company and a domestic trust) so that funds are routed directly to South African residents.

Admittedly, other structures do exist. Ministerial approved loops may exist when South African residents enter into joint arrangements with non-residents. The South African Reserve Bank may also accept the existence of a loop for a short period (typically no more than 12 months) if a South African resident acquires a foreign group that contains pre-existing South African subsidiaries/businesses. Outside these parameters, loop structures are largely illegal.

Proposal

The revised understanding of the DAT mechanism calls into question the need for providing tax relief in respect of loop structures. Most other loops are illegal. In respect of legally sanctioned loops outside the DAT, these loops are largely tolerated - not preferred. Hence, it is proposed that any existing tax relief for loop structures be repealed given the potential risk to the tax base that these structures pose.

Effective date

The proposed amendment will be effective along with the new Dividends Tax. Hence, this amendment will come into effect on a date set by the Minister by notice in the Gazette, which date must be at least three months from the date of the notice (see clause 56(2) of the 2008 Revenue Laws Amendment Act).

4.4.DEFERAL OF DEDUCTIONS RELATING TO OFFSHORE SHORT-TERM INSURANCE RESERVES

[Applicable provisions: subsection (2)(cA) of section 28]

Background

As a general matter, deductions are not allowed for reserve funds or capitalised amounts. However, an exception to this rule exists for short-term insurers. Taxpayers engaged in short-term insurance operations can deduct certain estimated liabilities arising from the short-term insurance business. This calculation takes into account amounts required by the Financial Services Board as a floor with the Commissioner

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empowered to make adjustments. As a technical matter, it appears that the rules relating to these deductions for estimated short-term insurance liabilities equally apply to domestic and foreign insurance operations.

Reasons for change

As a general matter, few offshore short-term insurance businesses should fall within the South African tax net. Most offshore short-term insurance operations controlled by South African companies will be conducted through foreign subsidiaries for a variety of reasons (e.g. regulation and the need for limited liability). Foreign subsidiaries engaged in foreign operations are generally not subject to South African tax unless that subsidiary qualifies as a controlled foreign company and that subsidiary is engaged in an insurance business so as to be viewed as a “foreign financial instrument holding company.” To be viewed as a “foreign financial instrument holding company”, the short-term insurance business must either: (i) not be regularly conducting business with unconnected clients, or (ii) generate more than 50 per cent of the principal trading income and gain from connected persons.

Given the narrow circumstances in which the South African tax system applies to offshore short-term insurance operations, it is highly questionable whether special relief for offshore short-term insurance estimated liabilities should exist. The short-term insurance companies at issue are likely to be suspect from tax compliance point of view. Moreover, the co-ordination role between SARS and the applicable regulator (existing for on-shore insurance businesses) will most likely be absent.

Proposal

It is proposed that allowable deductions for estimated liabilities under section 28 be limited solely to short-term insurance businesses carried out in the Republic. Offshore short-term insurers can continue to claim deductions for liabilities incurred in respect of premiums on reinsurance and in respect of actual liabilities in respect of claims.

Effective date

The proposed amendment will be effective for years of assessment commencing on or after the date of introduction of the legislation.

5. SPECIALISED ENTITIES AND CIRCUMSTANCES

5.1. AGRICULTURAL TRUSTS

[Applicable section: Paragraph 3(e) of Part I of the Ninth Schedule]

Background

The Marketing Act, 1968 (Act No. 59 1968) established Agricultural Control Boards. These Agricultural Control Boards fell under the indirect auspices of the Department of Agriculture. As indirectly controlled government parastatals, the Agricultural Control Boards qualified for tax exemption in terms of section 10(1) (cA) (i) the Income Tax Act.

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In 1996, the new Marketing of Agricultural Products Act, 1996 (Act No. 188 1996) came into force and repealed the Marketing Act, thereby resulting in the conversion of the Agricultural Control Boards into Agricultural Trusts.

The main purpose of the Agricultural Trusts is to promote South African agriculture in the areas of research, training, transformation services and other areas. The trusts are funded mainly by levies (statutorily imposed by the Department of Agriculture) and investment income. The Department of Agriculture continues to retain control over certain trustee positions, trustee rules amendments and certain cash flows (e.g. levies). In terms of the memorandum of understanding between the Agricultural Trusts and the Department of Agriculture, the Agricultural Trusts are required to spend at least 20 per cent of their income towards transformation services.

Reasons for change

The Agricultural Trusts by virtue of their legal status as trusts do not qualify for tax exemption in terms of section 10(1)(cA)(i) the Income Tax Act (unlike the former Agricultural Control Boards). In order for these Agricultural Trusts to qualify for tax exemption under current law, these trusts must fall under the exemption for public benefit organisations in respect of certain activities that qualify for tax exempt status. Most of the activities of the Agricultural Trusts qualify for relief, such as research (e.g. marketing and scientific) and training. However, transformation services for emerging farmers technically do not qualify for tax exempt status.

Proposal

In order to restore the complete exemption for entities mandated by the Department of Agriculture, transformation services for emerging farmers should qualify for tax exempt status. This exemption is related to the exemption for efforts to assist with land reform.

Effective date

It is proposed that the effective date for this amendment be the date of introduction of the Bill.

5.2. FSB CONSUMER EDUCATION FOUNDATION

[Applicable sections: Paragraph 4 of Part I and paragraph 3 of Part II of the Ninth Schedule]

Background

Functions of the FSB and the FSB Consumer Education Foundation (the "Foundation")

The Financial Services Board ("FSB") is a juristic person established in terms of section 2 of the Financial Services Board Act, 1990 (Act No. 97 of 1990) ("the FSB Act"). In terms of section 3 of the FSB Act, one of the functions of the FSB is "to promote programmes and initiatives by financial institutions and bodies representing the financial services

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industry to inform and educate users and potential users of financial products and services” (section 3(c) of the FSB Act).

The Foundation is a trust that has been formed by the FSB pursuant to the powers conferred upon the FSB by the FSB Act to accept funds for consumer education programmes. The Foundation receives and channels these funds to activities as agreed upon with the FSB. In terms of its legislative mandate, the FSB is required to use these funds to conduct educational programmes relating to financial services and products for the benefit of the public (or to appoint service providers to conduct these services).

Tax status of the FSB and the Foundation

The FSB is exempt from income tax in terms of section 10(1) (cA) (i) of the Income Tax Act. Donations to the FSB (as a section 10(1) (cA) (i) entity) are generally not deductible under section 18A unless it conducts a public benefit activity which has been approved in Part II of the Ninth Schedule. The Foundation is approved as a public benefit organisation but donations to the Foundation are similarly not tax deductible.

Reasons for change

The Foundation is an entity formed by the FSB to obtain voluntary funding on its behalf. This voluntary funding mechanism was chosen as the preferred course of action over a compulsory system (the latter of which would have generated tax deductible contributions under the general deduction formula of section 11(a)). While section 18A (1) (b) of the Income Tax Act makes provision for tax deductible donations in respect of organisations that fund section 10(1) (cA) (i) exempt entities (such as the FSB), the deduction for donations to such funding organisations applies only if the section 10(1) (cA) (i) entity carries on a public benefit activity approved under Part II of the Ninth Schedule. The activities of the FSB in this instance do not satisfy Part II even though many other educational activities fall within the Part II approved list.

Proposal

The FSB is required by law to perform educational programmes for financial services and products. In order to assist the FSB in raising these funds to perform these duties, it is proposed that changes should be made so that the above-mentioned activities fall under Part II of the Ninth Schedule so as to qualify as tax deductible donations. This classification under Part II would also mean that the Foundation (a funding organisation for the FSB) will become eligible to receive tax deductible contributions.

Effective date

It is proposed that the effective date for this amendment be the date of introduction of the Bill.

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5.3.TAX RELIEF FOR PUBLIC BENEFIT ORGANISATIONS AND RECREATIONAL CLUBS – RETROSPECTIVE APPROVAL

[Applicable sections: 30(3B) and 30A (4)]

Background

On 15 July 2001, a revised system of tax exemption for public benefit organisations (PBOs) was introduced. A consequential amendment was also introduced that provides the Commissioner with discretionary powers to retroactively approve: (i) pre-existing PBOs if these PBOs applied before 31 December 2004, or (ii) to newly formed PBOs if the latter apply before the last day of their first year of assessment.

With regard to recreational clubs, a revised system of tax exemption for recreational clubs was introduced in 2006. As with the revised system of exemption for PBOs, a consequential amendment was introduced that provides the Commissioner with discretionary powers to retroactively approve: (i) pre-existing clubs if these clubs applied before 31 March 2009, or (ii) to newly formed clubs if the latter apply before the last day of their first year of assessment.

Reasons for change

Many PBOs and clubs applying for exemption do so after several years of activity. This delay may stem from a lack of expertise or due to an over-emphasis on starting activities. Failure to seek prompt approval then keeps the relevant parties from subsequently seeking relief on a going forward basis because of concerns about the potential tax liability from pre-existing activities,

Proposal

If a PBO or recreational club applies for tax exempt status, it is proposed that the Commissioner be given discretionary powers to retroactively approve tax exemption status. This retroactive approval will be based on the tax law as existing on the date of approval. In order to obtain this relief, the Commissioner must be satisfied that the relevant PBO or club was substantially compliant with the current terms and conditions of existing exemption requirements. If approval by a PBO or club is sought several years after existence, the Commissioner has the power to apply exemption for prior years of substantial compliance.

Effective date

It is proposed that the effective date for this amendment be years of assessment ending on or after 1 January 2010.

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5.4. TRANSITIONAL PERIOD FOR REVISED TAXATION OF CLUBS

[Applicable section: 30A]

Background

Before 2006, recreational clubs previously enjoyed complete tax exemption, even if the club was partially involved in trading activities. In 2006, a system of partial taxation for clubs was introduced, whereby core club activities remained exempt but trading activities (and certain other non-core activities) became taxable. The new partial taxation regime also created formalised rules in order to apply for exemption. The new partial taxation regime generally came into operation in 2007, except for pre-existing clubs which became subject to the partial taxation regime from 31 March 2009.

Reasons for change

Recreational clubs have not come forward to register under the new regime as expected. The failure to come forward stems from a variety of causes, including a lack of expertise in tax matters among clubs. Concerns have accordingly been raised that the new regime will effectively trigger full taxation for most pre-existing clubs – a result that was never intended.

Proposal

In order to allow for a smooth transition period, it is proposed that the full exemption for clubs applicable prior to 2006 for clubs be extended until 30 September 2010. This implies that clubs previously enjoying exemption prior to 2007 will continue until the new deadline date of 30 September 2010. The new partial tax regime will then apply to clubs as from the first day of year of assessment commencing on or after 1 October 2010.

Effective date

It is proposed that the April 2007.

5.5. REPEAL OF PROVISIONAL TAX STATUS OF PUBLIC BENEFIT ORGANISATIONS, RECREATIONAL CLUBS AND HOME ASSOCIATIONS

[Applicable sections: Fourth Schedule, Paragraph 1 (“provisional taxpayer” definition)]

Background

PBOs, home associations etc... and clubs (as of 1 October 2010) are all subject to partial taxation. This taxation typically falls on trading activities and (in the case of home association etc... and clubs) on investment income. Due to this system of partial taxation, it was initially believed that these entities should be subject to provisional tax like any other taxable entity.

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Reasons for change

The treatment of PBOs, home associations etc... and clubs as provisional taxpayers was delayed because of the administrative complications of taxing these entities in this way. One serious difficulty not initially envisioned was how provisional tax should apply to amounts subject to exemption only up to a specified threshold. The required compliance systems for these entities are also too expensive and burdensome to expect timely payments.

Proposal

It is proposed that the decision to impose provisional tax on PBOs, home associations etc... and clubs should be reversed indefinitely. Hence, even if an entity of this kind has taxable trading or investment income, no provisional tax will be payable with any tax due arising only upon the year assessment.

Effective date

It is proposed that the effective date for this amendment be years of assessment ending on or after 1 January 2010.

5.6. DE MINIMIS THRESHOLDS: FOR BODIES CORPORATE, SHARE BLOCK COMPANIES AND HOME OWNERS ASSOCIATIONS

[Applicable sections 10(1) (e)]

Background

Bodies corporate, share block companies and homeowners associations are partially exempt. Their levies are completely exempt and these entities have an exempt monetary threshold of R50 000 in respect of other amounts.

Reasons for change

The monetary exemption thresholds are not entirely clear. The current wording may suggest an all-or-nothing approach. It is also uncertain how these thresholds apply if an entity has various categories of otherwise impermissible income.

Proposal

It is accordingly proposed that these monetary threshold be clarified. Separate other amounts under the threshold should be exempt even if the total exceeds the R50 000 amounts. Moreover, all otherwise impermissible amounts should be aggregated in respect of the threshold.

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Effective date

It is proposed that the effective date for this amendment be years of assessment ending on or after 1 January 2009.

5.7. CONVERTED SECTION 21 COMPANIES

Background

The Income Tax Act provides a number of benefits to certain forms of section 21 companies. For example PBOs and social clubs, receive exemption for much of their income.

Reasons for change

A number of tax benefits are restricted to companies “incorporated and formed” as section 21 companies. Hence, these benefits do not apply if a company was initially formed or incorporated as a for profit company and later converted to a section 21 company. No reason exists for this distinction.

Proposal

It is proposed that benefits related to section 21 companies should apply to all section 21 companies, whether they were initially formed and incorporated as section 21 companies or not.

Effective Date

It is proposed that the effective date for this amendment be the general effective date (i.e. 1 January 2010).

5.8. FILM CASH SUBSIDIES CONVERTED

[Applicable section: 10(1) (zG)]

Background

The Department of Trade and Industry provides subsidies in order to promote film production within South Africa. These subsidies typically have a R10 million ceiling per film. The tax system underpins this grant with tax-free treatment for receipt and accrual of this subsidy.

Reasons for change

The exemption applies to subsidy amounts received or accrued by a person. However, this subsidy cannot be passed on without triggering tax. This inability to pass the subsidy along is problematic given the practical mechanics relating to the subsidy as imposed by the Department of Trade and Industry.

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As a condition for the subsidy, the Department of Trade and Industry informally requires the use of the special purpose vehicle. The special purpose vehicle is needed as a separate mechanism for tracing all film funds associated with the subsidy. The use of this special purpose vehicle, however, undermines the tax-free treatment because transmission of the subsidy to the ultimate beneficiaries (e.g. to the investors) entitled to the subsidy typically triggers tax.

Proposal

The proposed amendment enhances the incentive to cater for subsequent transfers to investors. Accordingly, the payment of the subsidy to any film owner will be tax free.

Effective date

The amendment will be effective for all receipts accruals occurring on or after the date of introduction of the Bill.

5.9. FILM ALLOWANCE — REFINEMENT OF ANTI-AVOIDANCE RULES

[Applicable sections: 20(1) (a) (ii), 24F (1) (“completion date”), 24F (8)]

Background

As an incentive for domestic film production, film owners may utilise an upfront 100 per cent deduction for eligible production and post-production expenses associated with films produced. Like many film tax incentives globally, the 100 per cent deduction has unfortunately given rise to artificial schemes that undermined the South African tax base, almost all of which provided little benefit for local film production. Anti-avoidance rules inevitably followed as a response.

One response was the enactment of an at-risk limitation. This at-risk limitation ensures that expenses incurred out of borrowed proceeds receive the 100 per cent deduction only if the loan is to be repaid within 10 years (i.e. only if the loan is economically incurred in a meaningful way). The purpose of the at-risk rules is to prevent paper loans that stem from artificially inflated section 24F film expenses.

Reasons for change

While the purpose of the at-risk rules remains unquestioned (including the ten-year repayment rule), practical experience indicates a need for refinement. These refinements centre around two areas:

Firstly, the current at-risk rules are only forward looking. Film loans that are eventually cancelled do not necessarily give rise to ordinary recoupment (even though the initial loan proceeds give rise to an initial film allowance). Moreover, any taxation upon cancellation does not account for the time value benefit of the upfront film allowance.

Secondly, the ten-year repayment period for the film loan needs refinement to account for regular changes in interest rates. The ten-year repayment period may be too short in

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times of low interest rates (hindering finance for legitimate film production) and too long in times of high interest rates (giving rise to avoidance opportunities).

As a final matter, the current rules still allow for potential leakage from complex schemes devised by banks, insurers and other financial service businesses.

Proposal

Failure to repay the ten-year loan

The ten-year repayment rule does not properly account for failures to make repayment. Under current law, the failure to repay the loan can give rise to varied consequences – i.e. loss of excess losses, capital gain or ordinary revenue. Moreover, even if the failure to repay a film loan triggers ordinary revenue as a recoupment, this recoupment only nullifies the initial write-off in nominal terms but not in present value terms.

In order to ensure that taxpayers do not receive any nominal or present value benefits from failing to repay a ten-year film loan initially giving rise to ordinary deductions, a three-fold response is proposed. First, any unused losses derived from the cancelled loan will be eliminated. Second, any previously used losses derived from the cancelled loan will give rise to a recoupment. Third, the recoupment will be increased by the “prescribed rate” (see section 1 “prescribed rate” definition). The prescribed rate will be set utilising the rate in effect on the date that the film was acquired.

These changes should eliminate any nominal or present value arbitrage obtained from film loans that are ultimately cancelled. These changes also reduce the pressure on administrative enforcement when analysing whether the taxpayer is at-risk when entering into a film loan (i.e. when determining whether the loan is economically real).

Extended repayment period

The repayment period needs to be adjusted for an anticipated decline in variable interest rates. It is proposed that the ten-year period should be increased to 15 years. This expected period allows for a viable risk-free yield on the tax savings resulting from the film allowance (assuming the film losses give rise to a useable tax deduction during the year in which the film is acquired).

In order to ensure that the loan element of the film investment is not excessive, film loans will only be viewed as at-risk as long as the taxpayer makes a minimal cash (i.e. non-loan) contribution. In order to satisfy this minimum, the taxpayer must make a 14 per cent cash contribution (i.e. the loan may not exceed 86 per cent of the film allowance claimed). In effect, the 14 per cent cash infusion creates an added reality check in favour of meaningful film investments.

Banks, insurers and other financial service businesses

Government is currently aware of schemes in the market place involving banks, insurers and other financial service businesses. These schemes seek to cycle funds through complex film arrangements in order to obtain the film allowance while producing films of little or of no value. The commercial reality is that direct film investment is atypical for banks, insurers and financial service businesses given the high level of risk associated with films. It is accordingly proposed that the film allowance be disallowed if the film owner is a bank, insurer or a financial services business. This exclusion for banks, insurers and financial services is comparable to similar exclusions found elsewhere in the Act (such as the exclusion from the research and development incentive).

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Effective date

The proposed amendment will generally be effective for years of assessment ending on or after 1 January 2010. However, the prohibition for banks, insurers and other financial service businesses will apply only for years of assessment commencing on or after 1 January 2010.

6. ESTATE DUTY

6.1. PORTABLE SPOUSAL DEDUCTION

[Applicable section: 4A]

Background

An automatic deduction is allowed (currently at R 3.5 million) from the net value of an estate in order to calculate the dutiable amount in terms of the Estate Duty. Each spouse receives the deduction in his or her own estate. Unused amounts are not transferable.

Reasons for change

Married couples currently seek to maximise the R3.5 million deductions per spouse through one or more structures (e.g. trusts). The purpose of these structures is to ensure that R7 million of assets (i.e. R3.5 million per spouse) can be passed to the married couple's children free of Estate Duty. These structures create compliance costs and other complications. Moreover, many taxpayers cannot easily afford the use of an estate planning expert.

Proposal

The proposed amendment seeks to provide for portability of the automatic deduction in the case of simple wills. If a spouse leaves all of his or her assets to a single spouse, the surviving spouse will benefit from a double deduction at the time of the surviving spouse's death (currently at R3.5 million). If a deceased spouse has multiple concurrent spouses, the R3.5 million amount will be divided among the surviving spouses according to the value of the assets transferred per spouse. Hence, if a deceased spouse has two surviving spouses with one spouse receiving R2 million and the other receiving R4 million, the first surviving spouse's deduction on death will be increased by one-third and the second surviving spouse's deduction on death will be increased by two-thirds.

At this stage, the portability concept is limited solely to simple estates with assets solely transferred to spouses for a variety of reasons. First, only the will document itself is kept on permanent record for an indefinite period, and concerns exist that a doubling of a single automatic deduction can occur once documents are absent. The proposal is also intended to avoid estate planning for simple estates. Once an estate has a variety of heirs, the estate will already require attorney intervention, thereby obviating the need to create Estate Duty mechanisms for simplicity.

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Effective date

The proposed amendment is effective for any estate of a person who dies on or after 1 January 2010.

6.2. USUFRUCTORY ESTATE PLANNING SCHEME

[Applicable sections: 5(1) (b), (c), (d), (d)bis and (f)]

Background

The value of any usufruct fiduciary right or other like interest held prior to the deceased's death is included in the deceased's estate for estate duty purposes. These (usufructs) limited rights are valued by capitalising the annual value of the right of enjoyment of the property at a rate of 12 per cent. The period over which the value is capitalized equals the lesser of either: (i) the life expectation of the person who becomes entitled to any right of enjoyment over the property after death of the deceased (inheriting the usufruct), or (ii) the period of enjoyment by the same person.

Reasons for change

An avoidance scheme exists whereby the 12 per cent capitalisation rule is manipulated to artificially reduce values for Estate Duty purposes. In the scheme of concern, one spouse bequeaths a usufruct to a surviving spouse (in a will). The will of the first-dying spouse stipulates that, upon the death of the surviving spouse, the usufruct (fideicommissum or other like interest) is to be transferred to another person for one year – typically a trust or a child. The (underlying property) limited right is then transferred to the real heir for permanent use.

Since Estate Duty is levied on either the lifetime of the recipient of the (usufruct) limited right or over a shorter period if applicable, the shorter period is now applicable (i.e. at one year). This capitalisation to a single year significantly reduces the total Estate Duty payable.

Proposal

Usufructs, fideicommissum and other like interests are only to be valued over the life expectations of beneficiaries. The “lesser of” formulation for capitalizing values will be removed. As a result, an amount closer to the full value of a usufruct will be included in the deceased estate for Estate Duty purposes. As a collateral change, annuities will be valued over the expected duration of the annuity without regard to the time held by the annuitant.

Effective date

The proposed amendment is effective for any estate of a person who dies on or after 1 January 2010.

7. INDIRECT TAX

7.1. INDIRECT TAX TREATMENT OF SHARE BLOCK COMPANIES

[Applicable Transfer Duty sections: section 1 “fair value” and “property” definitions;
section 3(1A)]

Background

Fractional ownership of immovable property

Fractional ownership schemes in respect of South African immovable property basically have two different forms:

1. The buyer acquires an undivided interest in immovable property, or
2. The buyer acquires a share in a company, which owns the immovable property.

If the buyer acquires an undivided interest in immovable property, the buyer acquires a real right in the immovable property and is endorsed as a co-owner on the title deed of the immovable property (as long as that the real right is registered at the deeds office). If the buyer acquires a share in a company (which owns the immovable property), the buyer acquires a personal right vis-à-vis a real right. The buyer’s personal right entitles the buyer to a specified use in the immovable property.

Share Block Company

A company that operates a share block scheme is referred to as a share block company, within the confines of the Share Blocks Control Act (No. 59 of 1980). A share block scheme is specifically defined in the Act as: “. . . any scheme in terms of which a share confers a right to or an interest in the use of immovable property”.

Any company is presumed to operate a share block scheme if any share in the company confers a right to (or an interest in) the use of immovable property (section 4 of the Share Blocks Control Act). It follows that even an unregistered share block company is classified as a share block company for the purposes of the Share Blocks Control Act.

Value-added Tax (VAT)

VAT is levied on the supply of goods or services made by a vendor. The definition of ‘goods’ includes, inter alia, ‘immovable property’. Immovable property in turn is defined to include: “. . . any share in a share block company which confers a right to or an interest in the use of immovable property. . . .” It follows that a sale of a share in a share block company is subject to VAT if the seller is a vendor.

The Transfer Duty Act

The Transfer Duty Act is mainly designed to tax the acquisition of immovable property (falling outside the VAT). As an anti-avoidance measure, the Transfer Duty also applies to the acquisition of shares in companies mainly consisting of immovable property mainly dedicated to residential use. To be within this definition, the fair value of the immovable property in that company must comprise more than 50 per cent of the aggregate fair market value of all assets held by that company. For purposes of the 50 per cent calculation, dwellings-houses, holiday homes, apartments or similar abodes and land

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dedicated to residential use are viewed as immovable property, but hotels, apartments and similar structures of at least five units are excluded.

Reasons for change

There is a gap between the VAT Act and Transfer Duty Act where share block companies are concerned. A sale of a share in a share block company (which is akin to immovable property) may escape indirect taxation if certain conditions prevail. For example, if a share in a share block company is sold by a non-vendor shareholder, the supply of those goods falls outside of the VAT Act. The sale of the share also falls outside the ambit of the Transfer Duty Act if the requirements of residential property company are not satisfied.

One circumstance in which this gap may arise is the case of shares in a share block company offered as fractional shares. The initial sale by the developer will be subject to the VAT as fixed property, but the subsequent sales will generally fall outside the Transfer Duty. Most fractional share interests are in respect of an apartment complex, hotel or structure of five units or more.

Proposal

A share in a share block company is economically equivalent to a direct interest in immovable property and should be treated as such for purposes of the Transfer Duty. This treatment should apply regardless of the nature and percentage of immovable property held by the company. Once applicable, the fair value of the share block company will be measured without regard to liabilities, and the seller becomes jointly liable for any unpaid transfer duty. Both these requirements are consistent with the rules for residential property companies.

It should be noted that the proposal does not simply cover a 'registered' share block company. A company that is not registered in terms of the Share Blocks Control Act can also be caught by this proposal if deemed to be a share block by virtue of section 4 of the Act (due to the conferral of a right to or an interest in the use of immovable property).

The net impact of these changes is to ensure that shares in a share block company block are treated like section title interests. The sale by the developer will trigger the VAT; subsequent transfers will be subject to the Transfer Duty.

Effective date

The proposal will apply to all acquisitions in respect of a share in a share block company occurring on or after the date of introduction.

7.2. IMPACT OF VALUE-ADDED TAX ON RE-ORGANISATIONS

[Applicable sections: 8(25) and 8(25A)]

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Current Law

The VAT Act contains relief measures for transactions that fall into the ambit of the Income Tax reorganisation rollover provisions (i.e. section 42, 44, 45 or 47 of the Income Tax Act). This VAT relief effectively deems the seller and buyer (both being vendors) to be one and the same person. The effect is that the reorganisation for VAT purposes is deemed to be a non-event (no VAT is charged on the supply and no adjustments in terms of section 16(3)(h) and section 18A are applicable).

Reasons for change

Concerns exist that the current VAT relief for reorganisations is too broad. Of particular concern are the intra-group section 45 rules, which effectively can be viewed as a wholesale adoption of the group concept into VAT for all supplies (even the day-to-day supply of trading stock). In addition there may be instances where the vendor (who post the reorganisation, ceases to be a vendor), may have under-declared or under-claimed VAT.

Proposal

In light of the concerns above, it is proposed to amend the VAT reorganisation provisions. Firstly, the VAT reorganisation provisions will only apply to a supply contemplated in section 45 if that supply is a going concern. Where a single transfer of trading stock or a capital asset occurs under a section 45 transaction, the normal VAT rules will apply. Effectively, the relief provision under the reorganisation provisions as pertaining to a section 45 transaction is limited to going concern transfers. In a similar vein, section 42 VAT reorganisations are being removed from the VAT reorganisation provisions because section 42 mainly deals with single asset transfers

Secondly, the liability to account for output tax as well as the right to deduct input tax will be transferred to the person who remains a vendor. The proposed amendment is only applicable where the vendor who is a party to the reorganisation ceases to be a vendor after the reorganisation.

Effective date

These provisions will be come into operation on the date of introduction of this Bill.

8. SPECIAL MEASURES RELATING TO THE SHARING OF GENERAL FUEL LEVY REVENUE

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Background

The Minister of Finance in his 2005 Budget Speech announced the repeal of the regional services council (RSC) levies and regional establishment levies with effect from 1 July 2006.

The primary reason for repeal of the RSC levies and Joint Services Board (JSB) levies was to alleviate the administrative burden on businesses. In addition to this inefficiency, there was also inequity in that some municipalities received a disproportionate amount of revenue. Johannesburg and Cape Town, for example, benefited unfairly simply because most head offices are located in those centres.

Following the repeal of the RSC and JSB levies, municipal property rates were zero rated. This resulted in a cash flow benefit for municipalities in that they may claim more input tax. In addition all category A and C municipalities received an additional on budget grant to make up for the revenue shortfall.

Reasons for change

To ensure a more secure non-discretionary source of funding, it is proposed to replace the on budget grant to category A municipalities (to partly compensate for the loss in revenue as a result of the scrapping of the RSC and JSB levies) with a more direct source of revenue. Category C municipalities will continue to receive an on budget grant.

Proposal

It is proposed that from 2009/10, 23 per cent of the revenues from the general fuel levy be earmarked for metropolitan (Category A) municipalities. The distribution of this revenue among various metropolitan municipalities is to be phased in over four years. Ultimately, it is envisaged that the distribution of this revenue will be based on fuel sales in each metropolitan municipality.

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CLAUSE 01

Transfer Duty: Amendment of section 1 of the Transfer Duty Act, 1949

See notes on INDIRECT TAX TREATMENT OF SHARE BLOCK COMPANIES

CLAUSE 02

Transfer Duty: Amendment of section 3 of the Transfer Duty Act, 1949

See notes on INDIRECT TAX TREATMENT OF SHARE BLOCK COMPANIES

CLAUSE 03

Transfer Duty: Amendment of section 9 of the Transfer Duty Act, 1949

A number of the reorganisation rollover provisions are elective. Historically, taxpayers seeking to utilise these provisions had to make an affirmative election to obtain the desired rollover relief. In 2008, the election mechanism, in the context of income tax, was reversed. As a result of this reversal, the applicable rollover provisions apply unless the parties elect otherwise. The purpose of this reversal was to simplify compliance because most taxpayers would normally prefer rollover treatment but for unusual circumstances.

This reversal of the election mechanism, however, was not properly carried through to the Transfer Duty Act or to the Securities Transfer Tax Act. Both Acts currently provide exemption in terms of the reorganisation provisions based on the assumption that an election has to be made for the applicable reorganisation provisions to apply. It is therefore proposed that the language of the provisions of these Acts that deal with reorganisations be revised in light of the 2008 amendments reversing the election mechanism in the context of income tax.

CLAUSE 04

Transfer Duty: Amendment of section 9A of the Transfer Duty Act, 1949

This provision is repealed due to obsolescence.

CLAUSE 05

Estate Duty: The Estate Duty Act, 1955 is hereby amended by the substitution for section 4A

See notes on PORTABLE SPOUSAL DEDUCTION

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CLAUSE 06

Estate Duty: Amendment of section 5 of the Estate Duty Act, 1955

See notes on USUFRUCTORY ESTATE PLANNING SCHEME

CLAUSE 07

Fixing of rates of normal tax and amendment of certain amounts for purpose of Act 58 of 1962

See notes on RATES AND THRESHOLDS

CLAUSE 08

Income Tax: Amendment of section 1 of the Income Tax Act, 1962

Subclause (a-f): See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

Subclause (g): See notes on DIVIDENDS TAX: WITHHOLDING REFINEMENTS

Subclause (h): In 2008, a new “dividend” definition was added in light of the new Dividends Tax. Upon review, it was determined that the newly added definition was arguably too narrow and that many items currently viewed as deemed dividends under section 64C should be more appropriately characterised as actual dividends. The dividend definition was accordingly expanded in view of these concerns. Share transfers and the enhancement of share preferences, rights limitations or other terms has also become part of the definition but these transfers and enhancements will in some cases be exempt from the Dividends Tax (see notes on **DIVIDENDS TAX: DISTRIBUTIONS OF SHARES AND SHARE RIGHTS**).

Subclause (i): See notes on PAYOUTS OF EMPLOYER PENSION SURPLUSES

Subclause (j): See notes on **MINOR BENEFICIARY FUNDS**

Subclause (k): See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

Subclause (l): See notes on **FOREIGN PORTFOLIO DIVIDENDS**

Subclause (m): In 2008, two new retirement definitions were added: one for retirement fund lump sum benefits (i.e. lump sums received upon retirement or death) and one for retirement fund lump sum withdrawal benefits (i.e. lump sums received before retirement due to various causes such as retrenchment, job change and divorce). The proposed amendment adds a single definition (“lump sum benefit”) for referring to both forms of benefits.

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Subclause (n): The proposed amendment deletes the term “superannuation” because this definition of retirement fund savings is not used in South African parlance. Other changes include the removal of a superfluous “or” as well as the correction of cross-references.

Subclause (o): The proposed amendment corrects an error in numbering.

Subclause (p): The proposed amendment is a stylistic change to the divorce aspect of the definition of “pension preservation fund.” The amendment makes the language consistent with the style of the other aspects of the definition.

Subclause (q): The proposed amendment corrects an error in numbering.

Subclause (r): In 2008, legislative changes were made to clarify which forms of movement between the different types of retirement fund are taxable versus which are tax-free. As a theoretical matter, a tax-free movement takes place if the savings being moved move to the same or higher level of restrictiveness (see paragraph 6 of the Second Schedule). Consequently, for example, taxpayers may move savings from a retirement annuity fund to another retirement annuity fund. Savings within pension funds (and pension preservation funds) may be moved to other pension funds (and pension preservation funds) as well as to retirement annuity funds. Savings within provident funds (and provident preservation funds) may be moved to any other form of retirement fund.

The proposed amendment aligns paragraph (b)(ii) of the proviso to the definition of “pension preservation fund” (which applies in the context of divorce) with the principles set out above. More specifically, savings in both provident funds (plus provident preservation funds) and pension funds (plus pension preservation funds) may be transferred to pension preservation funds free of tax. Savings in retirement annuity funds cannot, however, be transferred to pension preservation funds without tax.

Subclause (s): The proposed amendment corrects an error in numbering.

Subclauses (t) and (u): See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

Subclauses (v) and (w): The proposed amendments corrects an error in numbering

Subclauses (x) and (y): In 2008, legislative changes were made to clarify which forms of movement between the different types of retirement fund are taxable versus which are tax-free. As a theoretical matter, a tax-free movement takes place if the savings being moved move to the same or higher level of restrictiveness (see paragraph 6 of the Second Schedule). Consequently, for example, taxpayers may move savings from a retirement annuity fund to another retirement annuity fund. Savings within pension funds (and pension preservation funds) may be moved to other pension funds (and pension preservation funds) as well as to retirement annuity funds. Savings within provident funds (and provident preservation funds) may be moved to any other form of retirement fund.

The proposed amendment aligns paragraph (b)(ii) of the proviso to the definition of “provident preservation fund” (which applies in the context of divorce) with the principles set out above. More specifically, savings in provident funds (and provident preservation

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funds) may only be transferred free of tax to a provident preservation fund. Savings within retirement annuity funds, pension funds and pension preservation funds cannot be transferred to pension preservation funds without tax being triggered.

Subclause (z - zB): The proposed amendments correct errors in numbering.

Subclause (zC): The proposed amendments clarify that the “retirement date” for triggering various retirement savings rules in the case of death occurs “on the death of the member.”

Subclause (zD-zE): The proposed amendments corrects errors in numbering.

Subclause (zF): It is clear from the judgment in *Richard's Bay Iron & Titanium(Pty) Ltd and Another v CIR* (58 SATC 55) that the Appeal Court (as it then was) considered mining stockpiles used for or created during the extraction or separation of minerals from ore or sand or their further beneficiation to be trading stock. These stockpiles are therefore subject to s 22 of the Income Tax Act with the result that the cost incurred in acquiring or creating them can, as a general rule, be deducted only upon their disposal. However, the Tax Court recently held that ore stockpiles acquired for purposes of extracting minerals by means of processes similar to those considered in *Richard's Bay Iron & Titanium* could not be regarded as trading stock and that the cost incurred in this regard could be deducted in full in the year of its incurral. This decision does not accord with the judgment in *Richard's Bay Iron & Titanium* and is being appealed.

The proposed amendment does not add anything to the views expressed by the Court in *Richard's Bay Iron & Titanium* regarding the nature of the mining stockpiles in issue – it merely confirms that those views reflect the law in this regard and that taxpayers cannot rely on the judgment of the Tax Court in any way.

CLAUSE 09

Income Tax: Amendment of section 5 of the Income Tax Act, 1962

This proposed amendment corrects an error in numbering.

CLAUSE 10

Income Tax: Amendment of section 6~~quat~~ of the Income Tax Act, 1962

See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

CLAUSE 11

Income Tax: Amendment of section 7 of the Income Tax Act, 1962

The proposed amendment treats all pre-retirement withdrawals from retirement savings as income accrued to the member (as opposed to the recipient) if the withdrawal stems

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from a maintenance order under section 37D(1)(d)(iA) of the Pension Funds Act. The recurrent nature limitation has been dropped. The amendment is based on the principle that taxpayers should not receive relief under the lump sum formula for forced payments of maintenance in arrears.

CLAUSE 12

Income Tax: Amendment of section 8 of the Income Tax Act, 1962

Subclause (a): See notes on TRAVEL (CAR) ALLOWANCES: REPEAL OF DEEMED KILOMETRE METHOD

Subclause (b-c): See notes on PAYOUTS OF EMPLOYER PENSION SURPLUSES

CLAUSE 13

Income Tax: Amendment of section 9 of the Income Tax Act, 1962

The proposed amendment clarifies that lump sum benefits (as with all other forms of retirement fund payouts) fall under the deemed source rules of section 9(1)(g).

CLAUSE 14

Income Tax: Amendment of section 9D of the Income Tax Act, 1962

Subclause (a): See notes on CONVERSION OF THE CONTROLLED FOREIGN COMPANY (CFC) RULING EXEMPTIONS

Subclause (b): This provision deletes an obsolete cross-reference

Subclause (c-e): See notes on CONVERSION OF THE CONTROLLED FOREIGN COMPANY (CFC) RULING EXEMPTIONS

CLAUSE 15

Income Tax: Amendment of section 10 of the Income Tax Act, 1962

Subclause (a): See notes on DE MINIMIS THRESHOLDS FOR BODIES CORPORATE SHARE BLOCK COMPANIES AND HOMEOWNERS ASSOCIATIONS

Subclause (b): See notes on **MINOR BENEFICIARY FUNDS**

Subclause (c): See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

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Subclause (d): See notes on RATES AND THRESHOLDS and COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

Subclause (e-f): See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

Subclause (g): See notes on REPEAL OF FOREIGN LOOP EXEMPTION

Subclause (h): See notes on **FOREIGN PORTFOLIO DIVIDENDS**

Subclause (i): See the clause-by-clause note relating to section 7(11). This exemption is no longer necessary because section 7(11) fully re-allocated the amount from the recipient to the member.

Subclause (j): See notes on **FILM CASH SUBSIDIES**

CLAUSE 16

Income Tax: Amendment of section 11 of the Income Tax Act, 1962

Subclause (a): This provision is repealed because it is obsolete in view of the enactment of section 24J.

Subclause (b-c): See notes on **DEPRECIATION ON IMPROVEMENTS**

Subclause (d): See notes on INTERNATIONAL SUBMARINE TELECOMMUNICATIONS CABLES

Subclause (e): The proposed amendment deletes an obsolete reference

Subclause (f): See notes on IMPROVEMENTS ON LEASED GOVERNMENT LAND

Subclause (g): See notes on RETIREMENT OF LUMP SUM BENEFIT CALCULATIONS

Subclause (h): See notes on DEDUCTIBILITY OF EMPLOYER CONTRIBUTIONS TO RETIREMENT ANNUITY FUNDS

Subclause (i): See notes on EMPLOYER-PROVIDED POST-RETIREMENT MEDICAL AID

CLAUSE 17

Income Tax: Amendment of section 11A of the Income Tax Act, 1962

Section 11A allows taxpayers to claim their pre-start up expenses even though a trade has not yet commenced. All deductions under section 11A are ring-fenced so as to useable only against present and future income from the same trade. The deductions

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allow cover all items listed in section 11 (other than section 11(x) which refers to deductions outside section 11(x)). When enacted in 2003, these deductions included all interest deductions relating to section 24J instruments because section 24J was previously only a timing provision (the deduction being granted by virtue of section 11(a) or (bA). Late in 2004, amendments were made so that section 24J shifted from a mere timing provision to a stand-alone deduction and income provision. A corresponding amendment to section 11A, however, was inadvertently omitted, thereby excluding section 24J from section 11A start-up relief. The cross-references to section 24J will accordingly be updated to include section 24J so as to restore the intent of the initial legislation.

CLAUSE 18

Income Tax: Amendment of section 11D of the Income Tax Act, 1962

See notes on DEPRECIATION ON IMPROVEMENTS

CLAUSE 19

Income Tax: Amendment of section 11E of the Income Tax Act, 1962

See notes on CONVERTED SECTION 21 COMPANIES

CLAUSE 20

Income Tax: Amendment of section 12B of the Income Tax Act, 1962

See notes on DEPRECIATION ON IMPROVEMENTS

CLAUSE 21

Income Tax: Amendment of section 12C of the Income Tax Act, 1962

See notes on DEPRECIATION ON IMPROVEMENTS

CLAUSE 22

Income Tax: Amendment of section 12D of the Income Tax Act, 1962

Subclause (a): See notes on INTERNATIONAL SUBMARINE TELECOMMUNICATIONS CABLES

Subclause (b-c): See notes on **DEPRECIATION ON IMPROVEMENTS**

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CLAUSE 23

Income Tax: Amendment of section 12E of the Income Tax Act, 1962

See notes on SHELF COMPANY START UPS AND SMALL BUSINESS RELIEF

CLAUSE 24

Income Tax: Amendment of section 12F of the Income Tax Act, 1962

See notes on DEPRECIATION ON IMPROVEMENTS

CLAUSE 25

Income Tax: Substitution of section 12H to the Income Tax Act, 1962

See notes on LEARNERSHIP ALLOWANCE SIMPLIFICATION

CLAUSE 26

Income Tax: Amendment of section 12I of Income Tax Act, 1962

Subclause (a-b): See notes on **DEPRECIATION ON IMPROVEMENTS**

Subclause (c): In 2008, an additional allowance incentive was enacted in terms of section 12I for the benefit of brownfield and greenfield industrial policy projects. This allowance is the successor to the former incentive for strategic industrial projects in terms of section 12G. Both provisions provide sizeable allowances upon approval by a joint departmental National Treasury and Trade and Industry adjudication committee. The current section 12I incentive contains rules to prevent taxpayers from splitting a single project into multiple sub-projects so to make artificial multiple claims for the same project. This rule against dividing a single project into multiple projects, however, applies so as to prevent the application of by a new section 12I brownfield project that is associated with a prior Greenfield section 12G project (even though both projects should be viewed as distinct from each other). The prohibition against integrally related section 12G and 12I projects will accordingly be dropped.

Subclause (d): Section 12I(7)(b) contains two requirements relating to tax compliance of a company that wishes to qualify for the section 12I allowance. Section 12I(7)(b)(i) requires the submission of a declaration of good standing as to tax compliance, and section 12I(7)(b)(ii) requires the submission of a certificate obtained from the Commissioner confirming tax compliance. On the basis that both requirements seek to achieve the same objective, it is proposed that the requirement to make submission of the declaration (as required by section 12I(7)(b)(i)) be deleted as superfluous.

CLAUSE 27

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Income Tax: Amendment of section 12J of the Income Tax Act, 1962

See notes on VENTURE CAPITAL COMPANY REFINEMENTS

CLAUSE 28

Income Tax: Amendment of section 12K of the Income Tax Act, 1962

See note on CERTIFIED EMISSION REDUCTIONS – TRADABLE CARBON CREDITS

CLAUSE 29

Income Tax: Amendment of section 12L of the Income Tax Act, 1962

See note on ENERGY EFFICIENCY

CLAUSE 30

Income Tax: Amendment of section 13*quat* of the Income Tax Act, 1962

Subclause (a): The proposed amendment deletes an obsolete reference.

Subclause (b): The proposed amendment corrects a cross-reference.

Subclause (c): The current wording covers how the depreciation calculation works when a taxpayer purchases part of a building from a developer. However, the wording fails to cover situations where the taxpayer purchases the whole building from a developer. The proposed amendment corrects this omission.

CLAUSE 31

Income Tax: Amendment of section 13*quin* of the Income Tax Act, 1962

The current wording covers how the depreciation calculation works when a taxpayer purchases part of a building from a developer. However, the wording fails to cover situations where the taxpayer purchases the whole building from a developer. The proposed amendment corrects this omission.

CLAUSE 32

Income Tax: Amendment of section 18 of the Income Tax Act, 1962

See notes on UNIFICATION OF EMPLOYMENT-RELATED MEDICAL SCHEME CONTRIBUTIONS

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CLAUSE 33

Income Tax: Amendment of section 20 of the Income Tax Act, 1962

See notes on PAYOUTS OF EMPLOYER PENSION SURPLUSES

CLAUSE 34

Income Tax: Amendment of section 20A of the Income Tax Act, 1962

The proposed amendment corrects an overly narrow cross-reference

CLAUSE 35

Income Tax: Insertion of section 22B in Income Tax Act, 1962

See notes on PRE-SALE DIVIDENDS/DIVIDENDS STRIPPING

CLAUSE 36

Income Tax: Amendment of section 23A of the Income Tax Act, 1962

See notes on ADJUSTING RING-FENCING OF LOSSES FOR FINANCIAL LEASING

Subclause (b): This proposed amendment adjusts the exclusion so that the language of the exclusion is consistent with a comparable exclusion in section 11D.

CLAUSE 37

Income Tax: Amendment of section 23I of the Income Tax Act, 1962

This amendment remedies an incorrect reference to a wrong definition.

CLAUSE 38

Income Tax: Amendment of section 24B of the Income Tax Act, 1962

See notes on CROSS-ISSUE AVOIDANCE – REMEDYING UNINTENDED ANOMALY

CLAUSE 39

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Income Tax: Amendment of section 24F of the Income Tax Act, 1962

See notes on FILM ALLOWANCE — REFINEMENT OF ANTI-AVOIDANCE RULES

CLAUSE 40

Income Tax: Amendment of 24I of the Income Tax Act, 1962

Section 24I(3)(c) regulated the timing of the accrual of a discount or the incurral of a premium in respect of a forward exchange contract in cases where a loan, advance or debt in a foreign currency was recorded on transaction date at the forward rate but the related expense or asset was recorded at spot rate. The option of recording a loan, advance or debt in a foreign currency at forward rate on transaction date for tax purposes is no longer available. Currently, all loans, advances and debts in a foreign currency must be translated at the spot rate on transaction date for tax purposes. It is, therefore, proposed that the obsolete section 24I (3)(c) be deleted.

CLAUSE 41

Income Tax: Insertion of section 25BA into Act 58 of 1962

See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

CLAUSE 42

Income Tax: Amendment of section 28 of the Income Tax Act, 1962

See notes on DENIAL OF DEDUCTIONS RELATING TO OFFSHORE SHORT-TERM INSURANCE RESERVES

CLAUSE 43

Income Tax: Amendment of section 30 of the Income Tax Act, 1962

Subclause (a): See notes on CONVERTED SECTION 21 COMPANIES

Subclause (b): See notes on TAX RELIEF FOR PUBLIC BENEFIT ORGANISATIONS AND RECREATIONAL CLUBS – RETROSPECTIVE APPROVAL

CLAUSE 44

Income Tax: Amendment of section 30A of the Income Tax Act, 1962

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See notes on TAX RELIEF FOR PUBLIC BENEFIT ORGANISATIONS AND RECREATIONAL CLUBS – RETROSPECTIVE APPROVAL

CLAUSE 45

Income Tax: Amendment of section 37B of the Income Tax Act, 1962

See notes on DEPRECIATION ON IMPROVEMENTS

CLAUSE 46

Income Tax: Amendment of section 38 of the Income Tax Act, 1962

See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

CLAUSE 47

Income Tax: Insertion of section 40D into the Income Tax Act, 1962

See notes on TELECOMMUNICATIONS LICENSE CONVERSION

CLAUSE 48

Income Tax: Amendment of section 41 of the Income Tax Act, 1962

Subclause (a): See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

Subclause (b): The proposed amendment is a style change. Reorganisation definitions should be contained in section 41, not in the substantive provisions.

CLAUSE 49

Income Tax: Amendment of section 42 of the Income Tax Act, 1962

The proposed amendment is a style change. Reorganisation definitions should be contained in section 41, not in the substantive provisions.

CLAUSE 50

Income Tax: Amendment of section 44 of the Income Tax Act, 1962

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Subclause (a): The proposed amendment is a style change. Reorganisation definitions should be contained in section 41, not in the substantive provisions.

Subclause (b): The proposed amendment corrects a cross-reference.

CLAUSE 51

Income Tax: Amendment of section 47 of the Income Tax Act, 1962

Section 47 does not generally apply to liquidations into a parent company if that company is exempt from tax. The purpose of this prohibition is to prevent the rollover deferral rules of section 47 from being turned into an outright exemption. The proposed amendment extends the prohibition to exempt mining rehabilitation companies and exempt bodies corporate. This change is consistent with similar prohibitions found in respect of other re-organisation rollovers.

CLAUSE 52

Income Tax: Amendment of section 64B of the Income Tax Act, 1962

Subclause (a): See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

Subclause (b): See notes on REPEAL OF FOREIGN LOOP EXEMPTION

Subclause (c): This amendment is associated with the 2008 introduction of the presumptive turnover tax. The amendment exempts up to R200 000 of dividends.

Subclause (d): See notes on COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

Subclause (e): See notes on **LIQUIDATING, WINDING UP OR DEREGISTRATION OF EXCLUSIVE RESIDENCE COMPANIES** for purposes of the addition of subsection (5)(k). in terms of subsection (5)(l), see the description of *subclause (c)*.

Subclause (f): The proposed amendment deletes obsolete language (i.e. language associated with the transition into section 29A).

CLAUSE 53

Income Tax: Amendment of section 64C of the Income Tax Act, 1962

The deemed dividend rules contain an exemption for intra-group transactions. Due to recent changes, the deemed dividend exemption for intra-group transactions now requires profits to be added to the intra-group payee to the extent profits of the intra-group payor are reduced. This additional rule ensures that the intra-group exemption

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operates only as a deferral mechanism (with the new profits giving rise to potential Secondary Tax on Companies sometime in the future).

The wording of the amendment, however, has caused confusion because the wording seems to require some addition to the profits of the payee even if no reduction occurs for the deemed dividend payor. This issue mainly arises in the case of intra-group loans, none of which require an adjustment to profits (neither as a subtraction for the payor or an addition for the payee). The wording of this profit adjustment requirement will accordingly be amended to clarify that an addition for the payee will be required if (and only if) a reduction exists for the payor.

CLAUSE 54

Income Tax: Amendment of section 64D of the Income Tax Act, 1962

Subclause (a): See notes on FOREIGN PORTFOLIO DIVIDENDS

Subclause (b): See notes on DIVIDENDS TAX: SPECIALISED REGULATED INTERMEDIARIES

CLAUSE 55

Income Tax: Amendment of section 64E of the Income Tax Act, 1962

Subclause (a): See notes on FOREIGN PORTFOLIO DIVIDENDS

Subclause (b): See notes on DIVIDENDS TAX: WITHHOLDING REFINEMENTS

CLAUSE 56

Income Tax: Amendment of section 64F of Act 58 of 1962,

See notes on FOREIGN PORTFOLIO DIVIDENDS

CLAUSE 57

Income Tax: Amendment of section 64G of the Income Tax Act, 1962

See notes on DIVIDENDS TAX: WITHHOLDING REFINEMENTS

CLAUSE 58

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Income Tax: Amendment of section 64H of the Income Tax Act, 1962

Subclause (a): See notes on DIVIDENDS TAX: WITHHOLDING REFINEMENTS

Subclause (b): See notes on DIVIDENDS TAX: SPECIALISED REGULATED INTERMEDIARIES and DIVIDENDS TAX: WITHHOLDING REFINEMENTS

Subclause (b): See notes on DIVIDENDS TAX: SPECIALISED REGULATED INTERMEDIARIES

CLAUSE 59

Income Tax: Amendment of section 64I of Income Tax Act, 1962

See notes on DIVIDENDS TAX: SPECIALISED REGULATED INTERMEDIARIES

CLAUSE 60

Income Tax: Amendment of section 64K of the Income Tax Act, 1962

See notes on DIVIDENDS TAX: WITHHOLDING REFINEMENTS

CLAUSE 61

Income Tax: Amendment of section 64L of the Income Tax Act, 1962

See notes on DIVIDENDS TAX: WITHHOLDING REFINEMENTS

CLAUSE 62

Income Tax: Insertion of section 64M in the Income Tax Act, 1962

See notes on DIVIDENDS TAX: WITHHOLDING REFINEMENTS

CLAUSE 63

Income Tax: Insertion of section 64N in the Income Tax Act, 1962

See notes on FOREIGN PORTFOLIO DIVIDENDS

CLAUSE 64

Income Tax: Insertion of section 64O in the Income Tax Act, 1962

See notes on DIVIDENDS TAX: DEEMED DIVIDENDS

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CLAUSE 65

Income Tax: Insertion of section 64P in the Income Tax Act, 1962

See notes on DIVIDENDS TAX: DEEMED DIVIDENDS

CLAUSE 66

Income Tax: Insertion of section 64Q in the Income Tax Act, 1962

See notes on DIVIDENDS TAX: DEEMED DIVIDENDS

CLAUSE 67

Income Tax: Insertion of section 64R in the Income Tax Act, 1962

See notes on DIVIDENDS TAX: DISTRIBUTIONS OF SHARES AND SHARE RIGHTS

CLAUSE 68

Income Tax: Amendment of paragraph 1 of the Second Schedule to the Income Tax Act, 1962

Subclause (a): See notes on RETIREMENT OF LUMP SUM BENEFIT CALCULATIONS

Subclause (b): See notes on REMEDIAL RECOGNITION OF PRE-1998 BENEFITS FOR PUBLIC SERVANTS

CLAUSE 69

Income Tax: Substitution of paragraph 2 of the Second Schedule to the Income Tax Act, 1962

The proposed amendment corrects various anomalies reflected in the core charging provision applicable to lump sum benefits.

Subparagraph (a): No changes to this subsection (which is the charging provision applicable to lump sums received or accrued on retirement) are proposed.

Subparagraph (b) of paragraph (i): This subsection is the charging provision applicable to pre-retirement lump sum withdrawals. It applies to lump sum withdrawals on divorce, transfers between funds and all other pre-retirement lump sum withdrawals.

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Divorce transfers (item (iA)): The proposed amendment provides a closer linkage between pension-related divorce orders and deductions from minimum individual reserves contemplated in section 37D(1)(d) of the Pension Funds Act. The first set of rules (under sub-item (AA)) covers attribution of withdrawals back to the member for pre-existing rules relating to divorces granted before 13 September 2007. The second set of rules (under sub-item (BB)) takes into account the “clean-break” principle (where the funds are immediately divided) applicable to divorces granted on or after 13 September 2007.

Fund transfers (item iB)): The proposed amendment taxes all transfers from a retirement fund to another retirement fund, with the date of accrual occurring on the date of transfer. (Exceptions to this principle are found in paragraph 6(b), i.e. if savings within a fund move to another fund of equal or greater restrictiveness).

All other transfers (item (ii)): The proposed amendment taxes all other pre-retirement lump sum benefits (e.g. upon resignation) in the same manner as under pre-existing law.

CLAUSE 70

Income Tax: Amendment of paragraph 2B of the Second to the Income Tax Act, 1962

The proposed amendment clarifies the relationship between pre-existing law and the revised system of taxation of retirement lump sums in the context of divorce. Amounts deducted from the minimum individual reserve in the context of divorce are taken into account under the newly revised paragraph 2(b)(iA). Amounts not so deducted are subject to pre-existing law (i.e. are taxable to the member only upon the member’s accrual (e.g. retirement or resignation)).

CLAUSE 71

Income Tax: Amendment of paragraph 3 of the Second Schedule to the Income Tax Act, 1962

Subclause (a): The proposed amendment changes the style to make provision easier to read

Subclause (b): The proposed amendment adds a missing word.

Subclause (e): See notes on **MINOR BENEFICIARY FUNDS**

CLAUSE 72

Income Tax: Amendment of paragraph 4 of Second Schedule to the Income Tax Act, 1962

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Subclause (a): The proposed amendment clarifies the applicable stakeholders in the case of pre-13 September 2007 divorces versus divorces granted from that date. More specifically, the rules need to account for the fact that the member takes into account lump sum withdrawals in terms of pre-existing rules; whereas, the revised clean-break principle requires the recipient spouse to take into account the lump sum withdrawals.

CLAUSE 73

Income Tax: Substitution of paragraph 5 of Second Schedule to the Income Tax Act, 1962

The proposed amendment provides a unified set of rules for allowable deductions in respect of retirement fund lump sum benefits (i.e. amounts outside the base for determining the lump sum tax calculation upon retirement). These deductions are as follows:

Subparagraph (a): Taxpayers can deduct from the lump sum calculation all amounts contributed to retirement saving that did not benefit from deduction on contribution.

Subparagraph (b): The division of retirement savings pursuant to divorce is deducted the lump sum calculation).

Subparagraph (c): Taxpayers can deduct amounts transferred to various retirement savings vehicles (e.g. pension funds and pension preservation funds).

Subparagraph (d): Amounts transferred to an unclaimed benefit fund can be deducted if those amounts were previously subject to tax.

Subparagraph (e): Pre-1998 accrued retirement benefits can be deducted from lump sums in respect of government employees.

These deductions are allowed as long as these deductions were not previously taken into account in terms of prior lump sums. Moreover, deductions may not exceed the gross lump sum (i.e. the calculation cannot yield a negative number).

CLAUSE 74

Income Tax: Substitution of paragraph 6 of Second Schedule to the Income Tax Act, 1962

The proposed amendment provides a unified set of rules for allowable deductions in respect of retirement fund lump sum withdrawal benefits (i.e. amounts outside the base for determining the lump sum tax calculation in respect of pre-retirement withdrawals). These deductions are as follows:

Subparagraph (a): Fund-to-fund transfers in respect of a single member or in the context

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of divorce will be deductible (i.e. outside lump sum taxation) as long as the fund transfer move the fund to an equal or more restrictive fund (e.g. a provident-to-pension fund transfer but not a pension-to-provident fund transfer).

Subparagraph (b):

Unit (i): Taxpayers can deduct from the lump sum calculation all amounts contributed to retirement saving that did not benefit from deduction on contribution.

Unit (ii): The division of retirement savings pursuant to divorce is deducted the lump sum calculation) stemming from an election as contemplated in section 37D(4)(b)(ii)(cc) of the Pension Funds Act.

Unit (iii): Taxpayers can deduct amounts transferred to various retirement savings vehicles (e.g. pension funds and pension preservation funds).

Unit (iv): Amounts transferred to an unclaimed benefit fund can be deducted if those amounts were previously subject to tax.

Unit (v): Pre-1998 accrued retirement benefits can be deducted from lump sums in respect of government employees.

These deductions are allowed as long as these deductions were not previously taken into account in terms of prior lump sums. Moreover, deductions may not exceed the gross lump sum (i.e. the calculation cannot yield a negative number).

CLAUSE 75

Income Tax: Amendment of paragraph 1 of the Fourth Schedule to the Income Tax Act, 1962

Subclause (a): See notes on REPEAL OF PROVISIONAL TAX STATUS OF PUBLIC BENEFIT ORGANISATIONS, RECREATIONAL CLUBS AND HOME ASSOCIATIONS

Subclause (b): See notes on TRAVEL (CAR) ALLOWANCES: REPEAL OF DEEMED KILOMETRE METHOD

Subclause (c): The proposed amendment explicitly requires monthly withholding for maintenance payments deducted from minimum individual reserves.

CLAUSE 76

Income Tax: Amendment of paragraph 2 of the Fourth Schedule to the Income Tax Act, 1962

Subclause (a): This amendment remedies an error with numbering.

Subclause (b-c): See notes on DEDUCTIBILITY OF EMPLOYER CONTRIBUTIONS TO RETIREMENT ANNUITY FUNDS

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CLAUSE 77

Income Tax: Amendment of paragraph 9 of the Fourth Schedule to the Income Tax Act, 1962

Transfers among retirement savings vehicles under section 14 of the Pension Funds Act are generally exempt from pay-as-you-earn withholding. However, transfers from pension (or from pension preservation) to provident funds are subject to pay-as-you-earn withholding because funds are moving to less restrictive forms of savings.

CLAUSE 78

Income Tax: Amendment of paragraph 18 of the Fourth Schedule to the Income Tax Act, 1962

See notes on RATES AND THRESHOLDS

CLAUSE 79

Income Tax: Amendment of paragraph 19 of the Fourth Schedule to the Income Tax Act, 1962

A concern has arisen that less sophisticated taxpayers may not always be able to adequately estimate their taxable income for purposes of paragraph 20 of the Fourth Schedule. These taxpayers will then be subject to a 20% penalty on underestimates unless they can satisfy the Commissioner that the estimates were not negligently or deliberately understated and were seriously calculated. In order to address this concern, provision is now made to allow the Commissioner to prescribe a method for determining an estimate of taxable income, taking into account any potential loss to the State, the size of the taxpayer and any other relevant circumstances. If a taxpayer follows the prescribed method the 20% penalty will be waived automatically. This will assist a large number of smaller taxpayers, while continuing to require larger taxpayers to prepare accurate estimates.

CLAUSE 80

Income Tax: Amendment of paragraph 3 of the Sixth Schedule to the Income Tax Act

See notes on SHELF COMPANY START UPS AND SMALL BUSINESS RELIEF

CLAUSE 81

Income Tax: Amendment of paragraph 9 of the Seventh Schedule to the Income Tax Act, 1962

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See notes on RATES AND THRESHOLDS

CLAUSE 82

Income Tax: Amendment of paragraph 12A of the Seventh Schedule to the Income Tax Act, 1962

See notes on UNIFICATION OF EMPLOYMENT-RELATED MEDICAL SCHEME CONTRIBUTIONS

CLAUSE 83

Income Tax: Amendment of paragraph 5 of the Eight Schedule to the Income Tax Act, 1962

See notes on RATES AND THRESHOLDS

CLAUSE 84

Income Tax: Amendment of paragraph 13 of the Eight Schedule to the Income Tax Act, 1962

This amendment adds a missing cross-reference

CLAUSE 85

Income Tax: Amendment of paragraph 19 of Eighth Schedule to the Income Tax Act, 1962

See notes on PRE-SALE DIVIDENDS/DIVIDENDS STRIPPING

CLAUSE 86

Income Tax: Amendment of paragraph 25 of the Eighth Schedule to the Income Tax Act, 1962

This amendment remedies an error with numbering.

CLAUSE 87

Income Tax: Amendment of paragraph 40 of Eighth Schedule to the Income Tax Act, 1962

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See notes on TREATMENT OF UNREALIZED GAINS ON DEATH

CLAUSE 88

Income Tax: Insertion of paragraph 43A in the Eighth Schedule to the Income Tax Act, 1962

See notes on PRE-SALE DIVIDENDS/DIVIDENDS STRIPPING

CLAUSE 89

Income Tax: Amendment of paragraph 45 of Eighth Schedule to the Income Tax Act, 1962

Under current law, taxpayers may exclude up to R1,5 million of any capital gain on the sale of a primary residence. As discussed in this year's Budget Review, it is proposed that taxpayers now be eligible: (i) for a complete exclusion in respect of the disposal of a primary residence where the proceeds from the disposal do not exceed R2 million, or (ii) an exclusion of up to R1,5 million of capital gain for primary residences where the proceeds from the disposal exceed R2 million.

CLAUSE 90

Income Tax: Amendment of paragraph 51A of Eighth Schedule to the Income Tax Act, 1962

See notes on LIQUIDATING, WINDING UP OR DEREGISTRATION OF EXCLUSIVE RESIDENCE COMPANIES

CLAUSE 91

Income Tax: Insertion of paragraph 67D in Eighth Schedule to the Income Tax Act, 1962

See notes on TELECOMMUNICATIONS LICENSE CONVERSION

CLAUSE 92

Income Tax: Amendment of paragraph 74 of the Eighth Schedule to the Income Tax Act, 1962

Subclause (a): In addition, the current formulation of "capital distribution" under the Eighth Schedule excludes any dividend that is not taxable by virtue of section 64B(5)(c). Section 64B(5)(c) excludes from the dividend definition pre-2001 capital profits and pre-1993 profits (both of which amount to effective date relief for STC). The section

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64B(5)(c) definition will no longer be relevant when the new Dividends Tax is enacted because the concept of profits will be eliminated. The reference to section 64B(5)(c) will accordingly be deleted.

Subclause (b): The Secondary Tax on Companies (STC) will soon be replaced with a new Dividends Tax. As a result, the definition of a dividend will become obsolete through the replacement of a new definition contained in the Revenue Laws Amendment Act, 2009 (to be effective when the new Dividends Tax becomes effective). A new broader definition will come into effect that basically seeks to treat all transfers by a company as a dividend to the extent the amounts are transferred by virtue of shares. One notable exception to this rule is the transfer of amounts that constitute a transfer of "capital tax capital."

The "distribution" definitions within the Eighth Schedule accordingly need to be realigned with the new dividend definition. In essence, the new distribution definition will mirror the new dividend definition except that the new capital distribution will apply regardless of whether the amounts transferred constitute "contributed tax capital" (unlike the dividend definition which excludes contributed tax capital). To the extent, the distribution is out of contributed tax capital, the distribution qualifies as a capital distribution (see revised "capital distribution definition"); otherwise the distribution constitutes a dividend (see revised "dividend" definition).

CLAUSE 93

Income Tax: Amendment of paragraph 75 of the Eighth Schedule to the Income Tax Act, 1962

Company distributions *in specie* constitute a disposal event that trigger capital gains or capital losses. The current wording specifically includes "interim dividends." In light of the fact that an interim dividend constitutes a distribution under current law (and will similarly constitute a distribution when the new Dividends Tax comes into effect), the current reference to an interim dividend will be deleted as superfluous.

CLAUSE 94

Income Tax: Amendment of paragraph 80 of the Eighth Schedule to the Income Tax Act, 1962

This proposed amendment corrects formatting.

CLAUSE 95

Income Tax: Amendment of paragraph 3 of part I of the Ninth Schedule to the Income Tax Act, 1962

See notes on AGRICULTURAL TRUSTS

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CLAUSE 100

Income Tax: Amendment of paragraph 4 of part I of Ninth Schedule to the Income Tax Act, 1962

See notes on FSB CONSUMER EDUCATION FOUNDATION

CLAUSE 101

Income Tax: Amendment of paragraph 3 of part II of Ninth Schedule to the Income Tax Act, 1962

See notes on FSB CONSUMER EDUCATION FOUNDATION

CLAUSE 102

Income Tax: Amendment of paragraph 1 of the Tenth Schedule to the Income Tax Act, 1962

See notes on OIL AND GAS INCENTIVES AND ANCILLARY TRADES

CLAUSE 103

Income Tax: Amendment of paragraph 3 of the Tenth Schedule to the Income Tax Act, 1962

See notes on OIL AND GAS INCENTIVES AND ANCILLARY TRADES

CLAUSE 104

Income Tax: Amendment of paragraph 5 of the Tenth Schedule to the Income Tax Act, 1962

See notes on OIL AND GAS INCENTIVES AND ANCILLARY TRADES

CLAUSE 105

Customs and Excise: Amendment of section 47B of the Customs and Excise Act, 1964

The air passenger departure tax was last adjusted for inflation in 2005. The Minister of Finance has therefore proposed an increase in the air passenger tax from R60 to R80 in respect of international departing passengers travelling to Botswana, Lesotho, Namibia and Swaziland, and from R120 to R150 for all other international flight destinations.

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The rate changes for Botswana, Lesotho, Namibia and Swaziland will be published by way of notice in the *Gazette*, and the rate change from R120 to R150 for other countries is contained in this Bill.

These changes will generally come into operation for flights commencing on or after 1 October 2009. The new rates will not, however, apply to flight tickets purchased and issued before this Bill is promulgated.

CLAUSE 106

Customs and Excise: Amendment of schedule No.1 to the Customs and Excise Act, 1964

This clause provides for the amendment of Schedule No. 1 to the Customs and Excise Act, 1964 referred to in Annexure C of the 2009 Budget Review. These amendments give effect to the taxation proposals which were tabled by the Minister of Finance during his Budget Speech on 11 February 2009 and contain the rates of duty in respect of alcohol and tobacco products.

CLAUSE 107

Customs and Excise: Continuation of certain amendments of Schedules to Act 91 of 1964

The proposed amendment brings the Ministerial decree into permanent legislation.

CLAUSE 108

Banks Act: Amendment of section 54 of the Banks Act, 1990

This proposed amendment is to cater for the repeal of Stamp Duty Act and to link the Banks Act to the Securities Transfer Tax Act, 2007. The proposed amendment also update the reference to the Commissioner of SARS.

CLAUSE 109

Value-Added Tax: Amendment of section 8 of the Value-Added Tax Act, 1991

See notes on IMPACT OF VALUE-ADDED TAX ON RE-ORGANISATIONS

CLAUSE 110

Value-Added Tax: Amendment of section 23 of the Value-Added Tax Act, 1991

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This clause provides for the increase of the voluntary registration VAT threshold from R20 000 to R50 000, effective only as of the 1 March 2010. The reasons for the change are to keep pace with inflation and to deter artificial registration for VAT.

CLAUSE 111

Taxation Laws: Amendment of schedule 3 of the Taxation Laws Amendment Act, 2004

In 2004, pre-existing government mineral lease arrangements were renewed despite the change in regulatory paradigm caused by the Mineral and Petroleum Resources Development Act. At that time, this continuation of lease arrangements was re-set to continue until 1 May 2009 when the new royalty charge on mineral and petroleum was anticipated. With the deferral of the Mineral and Petroleum Resources Royalty Act being until 1 March 2010, the rules for continuing current lease arrangements should be extended until the same date.

CLAUSE 112

Revenue Laws: Amendment of section 10 of the Revenue Laws Amendment Act, 2006

See notes on TRANSITIONAL PERIOD FOR REVISED TAXATION OF CLUBS

CLAUSE 113

Diamond Export Levy: Amendment of section 1 of the Diamond Export Levy Act, 2007

This amendment clarifies that the meaning of “value” is determined with reference to the Customs and Excise Act in respect of exported diamonds.

CLAUSE 114

Securities Transfer: Amendment of section 8 of the Securities Transfer Tax Act, 2007

A number of the reorganisation rollover provisions are elective. Historically, taxpayers seeking to utilise these provisions had to make an affirmative election to obtain the desired rollover relief. In 2008, the election mechanism, in the context of income tax, was reversed. As a result of this reversal, the applicable rollover provisions apply unless the parties elect otherwise. The purpose of this reversal was to simplify compliance because most taxpayers would normally prefer rollover treatment but for unusual circumstances.

This reversal of the election mechanism, however, was not properly carried through to the Transfer Duty Act or to the Securities Transfer Tax Act. Both Acts currently provide exemption in terms of the reorganisation provisions based on the assumption that an election has to be made for the applicable reorganisation provisions to apply. It is therefore proposed that the language of the provisions of these Acts that deal with

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reorganisations be revised in light of the 2008 amendments reversing the election mechanism in the context of income tax.

CLAUSE 115

Mineral and Petroleum: Amendment of section 5 of the Mineral and Petroleum Resources Royalty Act, 2008

In order to simplify compliance and enforcement, the proposed amendments eliminate two unnecessary differences between “income” under the Income Tax Act versus “income” and the earnings before interest and taxes (EBIT) calculation required by the Mineral and Petroleum Resources Royalty Act. Both differences do not justify the burden of maintaining two sets of calculations. Firstly, the “direct” limitation for EBIT deductions will be removed because this limitation unfairly penalises mining companies with a central head office operating multiple mines. Secondly, the EBIT calculation limits recoupments on disposals of capital expenditure assets to amounts previously deducted (e.g. amounts previously depreciated) in respect of those disposed assets. Whereas, the Income Tax Act treats all amounts received or accrued on disposal of capital expenditure assets as a recoupment regardless of previous deductions (see paragraph (j) of the gross income definition contained in section 1 of the Income Tax Act). While the EBIT limitation in respect of recoupments was designed to assist taxpayers, this small difference requires a complex set of additional calculations and maintenance records on cost that many mining operations fail to have. The EBIT recoupment limitation is accordingly removed in favour of the full recoupment rule of the Income Tax Act.

CLAUSE 116

Mineral and Petroleum: Amendment of section 9 of the Mineral and Petroleum Resources Royalty Act, 2008

The Mineral and petroleum Resources Royalty Act provides rollover relief if an extractor disposes of a mineral resource that forms part of a disposal of a going concern. In terms of these rollover rules, the disposal is ignored, and the recipient of the mineral resource is subject to a royalty charge when the recipient subsequently disposes of the mineral resource. While these rules provide relief, it has been suggested that these rollover rules are too restrictive and that no reason exists to deviate from the rollover rules of the Income Tax Act (the latter of which are already incorporated into the earnings before interest and tax calculation). The current going concern rule is more akin to the value-added tax, which is wholly unrelated to the Mineral and Petroleum Resources Royalty Act calculation.

It is accordingly proposed that royalty rollovers match Income Tax reorganization rollovers with one important caveat. In order to access the newly proposed royalty rollover rules, both the transferor and transferee must qualify as registered persons under the Mineral and Petroleum Resources Royalty (Administration) Act immediately after the reorganization id that registration qualification stems from the holding of rights granted pursuant the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2008). This registration caveat ensures that enforcement effort need not be

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extended to a new category persons who would otherwise fall outside the narrow pool of persons already subject to Mineral and Petroleum Resources Royalty Act.

CLAUSE 117

See notes on MINERAL AND PETROLEUM ROYALTY ACT: LIMESTONE AND GYPSUM

CLAUSE 118

Mineral and Petroleum: Amendment of schedule 2 to the Mineral and Petroleum Resources Royalty Act, 2008

The proposed amendments revise the unrefined condition of limestone and specifically add gypsum to Schedule 2. Previously, the unrefined condition (i.e. deemed first-saleable point that triggered the royalty) for limestone was: "Concentrate with a minimum of 54% CaCO₃". The proposed amendment, however, allows limestone to be sold in a range (i.e. 54% to 90% CaCO₃) to satisfy the unrefined condition requirement. This change takes into account the practical reality that limestone producers can readily sell limestone in variable initial unrefined forms depending on the nature of the site and the operations (with no one form predominating over the others). Moreover, the proposed amendments specifically add gypsum in the form of bulk or concentrate.

CLAUSE 119

Revenue Laws: Amendment of section 18 of the Revenue Laws Amendment Act, 2008

The date of coming into operation of the Mineral and Petroleum Resources Royalty Act, 2008 has been deferred from 1 May 2009 to 1 March 2010. The proposed amendments defer certain sections in this Act for purposes of deferring liability for the royalty and administrative efficiency. For instance, provisions in the Act that trigger the royalty (or relate to liability for the royalty) in respect of transferred mineral resources have been postponed to 1 March 2010. Moreover, registered persons may conclude Fiscal Stability Agreements with the Minister of Finance as early as 1 November 2009. However, such agreements only apply in respect of mineral resources transferred on or after 1 March 2010.

CLAUSE 120

Revenue Laws: Amendment of section 59 of the Revenue Laws Amendment Act, 2008
The proposed amendment sets the effective date at 1 August 2008 for the pre-existing fund-to-fund transfer relief so that these rules are aligned to section 14 transfers occurring under the Pensions Funds Act. The newly proposed fund-to-fund transfer rules apply from 1 March 2009.

CLAUSE 121

DRAFT

Special measures relating to sharing of fuel levy revenue

See notes on SPECIAL MEASURES RELATING TO THE SHARING OF GENERAL FUEL LEVY REVENUE

CLAUSE 122

Short title and commencement